89-2016

No.

Supreme Court, U.S.
FILED
JUN 21 1990
JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1989

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

ASSOCIATED GAS DISTRIBUTORS, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTION PRESENTED

This case involves the validity of orders of the Federal Energy Regulatory Commission that establish a prospective change in rates charged by a natural gas pipeline to its customers to reflect current costs incurred by the pipeline in settling its liability under "take-or-pay" clauses in its contracts with natural gas producers. A take-or-pay clause obligates the pipeline to purchase a certain amount of gas from the producer and to pay a specified price for that amount even if the pipeline does not take the gas.

The question presented is:

Whether the Commission orders violate the provisions of Sections 4 and 5 of the Natural Gas Act of 1938, 15 U.S.C. 717c and 717d, that comprise the "filed rate doctrine," because the orders allocate the pipeline's costs of settling its take-or-pay liability among its current customers based on the extent to which a past decline in each customer's purchases from the pipeline contributed to the pipeline's "take-or-pay" liability to producers.

PARTIES TO THE PROCEEDING

In addition to the Federal Energy Regulatory Commission, the parties to the proceedings in the court of appeals were:

Alabama-Tennessee Natural
American Iron and Steel Institute
American Paper Institute, Inc.
Arco Oil and Gas Company
Arkla, Inc.
Associated Gas Distributors
Baltimore Gas & Electric Company
Berkshire Gas Company, et al.
Brooklyn Union Gas Company
Cabot Corporation
Central Hudson Gas and Electric Corp.
Chattanooga Gas Company
Cities of Clarksville, Springfield and Portland, Tennessee, and Humphreys County Utility District
CNG Transmission Corporation
Columbia Gas Distribution Companies
Columbia Gas of Kentucky, et al.
Columbia Gas Transmission Corp.
Connecticut Natural Gas Corp.
Consolidated Edison Company of New York, Inc.
Dayton Power & Light Company
East Tennessee Group
Equitable Gas Company
Inland Gas Company, Inc.
Long Island Lighting Company
Maryland People's Counsel
Nashville Gas Company
National Fuel Gas Supply Corp.
New York State Electric & Gas Corporation

North Carolina Utilities Comm.
North Penn Gas Co.
Northern Illinois Gas Co.
Northern Indiana Public Service Company
Office of Consumers' Counsel, State of Ohio
Orange & Rockland Utilities
Niagara Mohawk Power Corp.
Pennsylvania Gas & Water Company
Pennsylvania Public Utility Commission
Peoples Natural Gas
Peoples Gas Light and Coke Co.
Process Gas Consumers Group
Public Service Commission of New York
Public Service Electric & Gas Company
Rochester Gas & Electric Corp.
Shell Offshore Inc. and Shell Western E&P Inc.
Southern Natural Gas Company
Tennessee Gas Pipeline Company
Tennessee Small General Service Customer Group
Texas Eastern Transmission Corporation
Transcontinental Gas Pipe Line Corporation
United Gas Pipe Line Company
Washington Gas Light Company
Western Kentucky Gas Company

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The Acting Solicitor General, on behalf of the Federal Energy Regulatory Commission, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-25a) is reported at 893 F.2d 349. The opinions on denial of rehearing en banc (App., *infra*, 137a-142a) are not reported. The orders of the Federal Energy Regulatory Commission dated February 8, May 27, July 8, and July 28, 1988 (App., *infra*, 26a-136a) are reported at 42 F.E.R.C. ¶ 61,175, 43 F.E.R.C. ¶ 61,329, 44 F.E.R.C. ¶ 61,039, and 44 F.E.R.C. ¶ 61,155, respectively.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 143a-144a) was entered on December 28, 1989, and petitions for rehearing were denied on March 30, 1990 (App., *infra*, 137a-142a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

Sections 4 and 5 of the Natural Gas Act of 1938, 15 U.S.C. 717c and 717d, are reproduced at App., *infra*, 145a-149a.

STATEMENT

The court of appeals in this case held that orders issued by the Federal Energy Regulatory Commission, which establish prospective rates to be charged by a pipeline to recover a portion of the costs incurred in settling contractual liabilities to gas producers, violate the "filed rate doctrine." App., *infra*, 6a-11a. This Court has described that doctrine as "forbid[ding] a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority." *Arkansas Louisiana Gas Co* v. *Hall* [*Arkla*], 453 U.S. 571, 577 (1981). At bottom, the filed rate doctrine is simply a label attached by the courts and others to describe provisions in various regulatory Acts of Congress that prescribe the procedures and substantive standards to be followed in setting rates and the effect that must be given to those rates. See, *e.g.*, *Arkla*, 453 U.S. at 577-578. For this reason, a case involving the filed rate doctrine is nothing more or less than a case of statutory construction. See *Maislin Industries U.S., Inc.* v. *Primary Steel, Inc.*, No. 89-624 (June 21, 1990), slip op. 9, 10-11, 12-13, 14-15. It therefore is useful at the outset to describe the statutory framework under which the present case arises.

A. The Statutory Framework

Natural gas companies as an initial matter set their own rates for the sale or transportation of gas, typically by contract with their customers. *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 341 (1956). However, Section 4(a) of the Natural Gas Act of 1938 (NGA), 15 U.S.C. 717c(a), provides that all rates received by a natural gas company in connection with the sale or transportation of gas subject to the jurisdiction of the Commission shall be "just and reasonable," and "any such rate or charge that is not just and reasonable is declared to be unlawful." Section 4(a) does not confer a right enforceable by the courts in the first instance. Rather, "the prescription of the statute is a standard for the Commission to apply," and "the right to a reasonable rate is the right to the rate which the Commission files or fixes." *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251 (1951).

To preserve the Commission's primary jurisdiction over this and other statutory prescriptions, Section 4(c) of the NGA, 15 U.S.C. 717c(c), requires a gas company to file with the Commission all proposed rates and contracts for the sale or transportation of gas, which then may be modified or rejected by the Commission. Under Section 4(d), a gas company may not make any change in a filed rate, classification, or service, or in any rule, regulation, or contract relating thereto, "except after thirty days' notice to the Commission and to the public." 15 U.S.C. 717c(d). If a rate change is one the gas company has the contractual power to make, it is "completed upon compliance with the notice requirement and the new rate has the same force as any other rate—it can be set aside only upon being found unlawful by the Commission." *Mobile Gas*, 350 U.S. at 342. The Commission does, however, have authority under Section 4(e) of the NGA, 15 U.S.C.

717c(e), to preserve the status quo pending its review of a new rate by suspending the proposal for not more than five months, and thereafter to make its order retroactive to the date the change became effective and to order a refund of any proposed rates found to be unjust or unreasonable. See *Mobile Gas*, 350 U.S. at 341.

The Commission also is empowered to review existing rates and practices of natural gas companies. Section 5(a) of the NGA, 15 U.S.C. 717d(a), provides that if the Commission finds after a hearing that any rate charged by a gas company, or any rule, practice or contract affecting a rate or classification, is unjust, unreasonable, unduly discriminatory, or preferential, "the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order." The Commission cannot, however, impose a retroactive rate alteration under Section 5(a), and it has no power to order payment of reparations if it finds that rates previously in effect were unjust or unreasonable. See *Arkla*, 453 U.S. at 578; *FPC* v. *Sunray DX Oil Co.*, 391 U.S. 9, 24 (1968); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 618 (1944). Under the statutory standard of "just and reasonable" in Section 5(a), like that in Section 4(a), "it is the result reached not the method employed which is controlling. * * * If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end." *Hope Natural Gas Co.*, 320 U.S. at 602. See also *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968); *Duquesne Light Co.* v. *Barasch*, 109 S. Ct. 609, 617 (1989).

B. The Background Of The Take-Or-Pay Problem

1. This case arises from the Commission's attempts to address the problem of "take-or-pay" clauses in con-

tracts that many pipelines entered into with producers between 1977 and 1982, when the price of natural gas was much higher than it is today. See Order No. 500-H, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, FERC Stats. & Regs., Regulations Preambles ¶ 30,867, at 31,509 (Dec. 13, 1989). A take-or-pay clause obligates a pipeline to purchase a certain amount of gas at a specified price and to pay for the gas even if it is not taken. Such clauses permit a pipeline to make up a deficiency by purchasing additional gas over a succeeding period, typically five years. *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Board*, 474 U.S. 409, 412 (1986).

By 1982, the supply of natural gas began to exceed demand, primarily because of the price incentives and phased deregulation schedule for "new" gas under the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq*. Demand for natural gas then began to fall, due to warm winters, a recession, and customers' switching to alternative fuels when world oil prices fell dramatically. As a result, by the end of 1983, the take-or-pay exposure of pipelines already exceeded $5 billion. Order No. 500-H, FERC Stats. & Regs. at 31,510.

The price of natural gas continued to rise even as demand fell, because pipelines generally had monopoly power over their service areas. At the time, most pipelines were essentially merchants: they purchased gas from producers, transported the gas, and then resold it to local distribution companies (LDCs) or, in some instances, to other interstate pipelines or end users. Typically, the LDCs in a given area were served by only one pipeline, which refused to transport gas that LDCs and end users purchased directly from producers if to do so would compete with the pipeline's own sales. This regime was maintained by the "minimum bill" provisions in many tariffs,

which obligated LDCs to pay a portion of the pipeline's costs, including the cost of gas, even if the LDCs did not purchase gas from the pipeline. "These practices frustrated the move toward a competitive wellhead market initiated by Congress in the NGPA, since purchasers could not obtain access to cheaper sources of supply than those provided by the pipelines, for example, by purchasing directly from the producer." Order No. 500-H, FERC Stats. & Regs., at 31,510.

In the early 1980s, the Commission, in an effort to effectuate the more competitive wellhead market instituted by the NGPA, moved to eliminate the minimum bill arrangement between pipelines and their customers, finding it anticompetitive. Order No. 380 [1] required pipelines to eliminate their variable costs from all minimum bills. That order was essentially sustained in *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144 (D.C. Cir. 1985), cert. denied, 476 U.S. 1114 (1986). Minimum bills thereafter were eliminated altogether on a case-by-case basis. Order No. 500-H, FERC Stats. & Regs., at 31,510-31,511; see, *e.g.*, *East Tennessee Natural Gas Co.* v. *FERC*, 863 F.2d 932 (D.C. Cir. 1988); *Transwestern Pipeline Co.* v. *FERC*, 820 F.2d 733 (5th Cir. 1987), cert. denied, 484 U.S. 1005 (1988). As a result, customers were no longer legally obligated to purchase a certain amount of gas from a particular pipeline, and pipelines were no longer guaranteed a minimum amount of revenue.

Elimination of the minimum-bill device did not immediately free LDCs and other pipeline customers to obtain gas from other sources to supply. Pipelines retained their monopoly positions in local markets and refused to

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[1] *Elimination of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions*, FERC Stats. & Regs., Regulations Preambles [1982-1985] ¶ 30,571 (June 1, 1984).

transport gas that would displace their own sales and thereby increase their take-or-pay liability. The Commission initially sought to address this problem by granting pipelines the incentive of blanket certificates to transport gas, albeit only on behalf of lower-priority customers who could readily switch to other fuels and who could therefore leave the pipeline system altogether. These orders were invalidated by the D.C. Circuit because the Commission had not adequately explained why the benefit of free access to competitively priced gas at the wellhead was not extended to captive customers of the pipeline. *Maryland People's Counsel* v. *FERC*, 761 F.2d 768 (D.C. Cir. 1985), and 768 F.2d 450 (D.C. Cir. 1985). See Order No. 500-H, FERC Stats. & Regs. at 31,511.

2. These events led to the much broader approach the Commission took in 1985 in Order No. 436,[2] which "envisage[d] a complete restructuring of the natural gas industry." *Associated Gas Distributors* v. *FERC* (*AGD I*), 824 F.2d 981, 993 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988). In Order No. 436, the Commission instituted a program to encourage open access to all major pipelines, so that LDCs and other customers could purchase gas directly from producers. The Commission found the pipelines' practice of refusing to transport gas in competition with their own sales to be unduly discriminatory because it denied consumers access to gas at the lowest reasonable prices. The Commission also found that the practice was frustrating the NGPA's goal of relying on a competitive wellhead market in reducing prices. To correct

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[2] Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, FERC Stats. & Regs., Regulations Preambles [1982-1985] ¶ 30,665 (Oct. 9, 1985).

that situation, Order No. 436 required pipelines seeking blanket authorization for transportation to become open-access pipelines, prohibited pipelines from refusing to transport gas in competition with their own sales, and required open-access pipelines to allow their firm-sales customers to convert their contract demand rights (the right to purchase a specified amount of gas from the pipeline) into a right to firm transportation of gas by the pipeline. See *AGD I*, 824 F.2d at 996, 1016-1018; Order No. 500-H, FERC Stats. & Regs., at 31,512.

The D.C. Circuit sustained most features of Order No. 436 in *AGD I*, but remanded for further proceedings on certain issues. In particular, the D.C. Circuit held that the Commission had erred in failing either to address the pipelines' take-or-pay problems in connection with its new open-access policy or to explain adequately its reasons for not doing so. The court was concerned that Order No. 436 would enable more pipeline customers to purchase cheaper gas directly from producers, thereby increasing the pipelines' take-or-pay exposure, and would deny pipelines bargaining leverage in settling their take-or-pay liability with producers. See *AGD I*, 824 F.2d at 1020-1030.

On remand following *AGD I*, the Commission adopted Order No. 500, an interim rule that instituted a policy of "equitable sharing" of take-or-pay liability across the natural gas industry—*i.e.*, among producers, pipelines, and customers. The final version of this rule, Order No. 500-H, was issued on December 13, 1989.[3] Order No.

[3] Order No. 500 was issued as an interim final rule and policy statement in August 1987. FERC Stats. & Regs., Regulations Preambles ¶ 30,761. Order No. 500-H was issued on the limited remand in *American Gas Ass'n* v. *FERC*, 888 F.2d 136 (D.C. Cir. 1989) [*AGA*], in which the court considered challenges to Order No. 500. Order No. 500-H, as modified on rehearing by Order No. 500-I, FERC Stats. & Regs., Regulations Preambles ¶ 30,880 (Feb. 12, 1990), is now pending on judicial review in *AGA*, following that limited remand.

500-H essentially retains the provisions of Order No. 436 that prescribe incentives for pipelines to assume open-access status and permit customers to convert contract demand rights to transportation rights. See 18 C.F.R. 284.10. Order No. 500-H also encourages producers and pipelines to enter into settlements under which the pipelines would "buy down" their existing take-or-pay contracts by reforming the pertinent provisions and "buy out" their accrued liability under those contracts. To furnish an incentive for producers to agree to such settlements, the Order permits a pipeline to refuse to transport gas unless the producer agrees (with certain exceptions) to credit the transported gas against the pipeline's take-or-pay liability. Order No. 500-H, FERC Stats. & Regs. at 31,525-31,536; see 18 C.F.R. 284.8(f), 284.9(f).

Order No. 500-H also encourages pipelines and their customers to share the cost of payments made by pipelines for the portion of their take-or-pay exposure that producers do not absorb. The Order permits a pipeline to pass its prudently incurred buydown and buyout costs through to customers in their commodity gas sales rates, the traditional means of recovering costs. 18 C.F.R. 2.108(a). However, the Commission was concerned that open-access pipelines' loss of sales might accelerate if the price of gas was substantially increased by a straight surcharge. The Commission therefore designed an alternative mechanism for open-access pipelines to share with their customers a portion of the costs incurred in settling their take-or-pay liability. Under this alternative, if the pipeline agrees to absorb between 25% and 50% of the buydown and buyout costs, it may recover an equal amount by means of a direct charge to its customers, rather than a

surcharge on gas sold.[4] The pipeline then may attempt to recover the balance, if any, by means of a volumetric surcharge on both sales and transportation of gas. Order No. 500-H, FERC Stats. & Regs. at 31,574-31,576.[5]

The Commission determined that the costs not absorbed by the pipeline under the alternative method should be allocated fairly among its customers based upon their responsibility for the pipeline's incurring the take-or-pay liability. Accordingly, the direct charge imposed upon each customer is based generally upon the cumulative deficiency of purchases by that customer in recent years, as compared with its purchases during a representative prior period when the pipeline had not yet begun to accrue take-or-pay liability. App., *infra*, 4a, 85a; see 18 C.F.R. 2.104(b). Under this approach, known as the "purchase deficiency" method of allocation, customers who reduced their purchases from the pipeline to buy cheaper gas at the wellhead bear a greater share of the cost of resolving the pipeline's take-or-pay liability than more captive customers whose purchase levels remained relatively constant. Order No. 500-I, FERC Stats. & Regs., Regulations Pre-

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[4] A direct charge is a monthly bill from the pipeline to its customer over a defined period, perhaps between two and five years, that does not vary based on the amount of gas purchased (or not purchased) by the customer during the collection period.

[5] Order No. 500-H establishes a presumption that the portion of a pipeline's take-or-pay costs it does not absorb were prudently incurred. If a customer agrees to accept the settlement under Order No. 500-H, it cannot challenge that presumption. This procedure was designed to avoid lengthy hearings on prudence or blame for the take-or-pay problem. App., *infra*, 4a; *AGA*, 888 F.2d at 144; Order No. 500, FERC Stats. & Regs. at 30,787-30,788.

ambles ¶ 30,880, at 31,720 (Feb. 12, 1990); [6] Order No. 500, FERC Stats. & Regs. at 30,785, 30,786-30,787.

3. The Commission's "equitable sharing" policy has furnished a substantial impetus for producers and pipelines to settle the latter's take-or-pay liabilities. Through such settlements, pipelines have been able to reduce their current take-or-pay liabilities by $16 billion and, through contract reformation, to obtain future relief in the amount of $28 billion. At the end of 1989, pipelines had paid producers approximately $8.6 billion to obtain this relief, or an average of 18.6 cents on each dollar of liability. Of this $8.6 billion, pipelines have absorbed 39.3% ($3.4 billion), received an equivalent amount through direct billing of their customers under the "purchase deficiency" method, and assessed the remainder through volumetric surcharges on both sales and transportation. Order No. 500-H, FERC Stats. & Regs. at 31,522-31,523.

C. The Proceedings In This Case

1. This case involves an application of the Commission's "equitable sharing" policy to a particular pipeline,

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[6] The Commission explained on rehearing in Order No. 500-I, at 31,720:

> The Commission continues to believe that purchase deficiency allocation is the most equitable method for allocating the take-or-pay costs included in the fixed take-or-pay charge among pipeline customers because that method, while not perfect, most closely matches cost causation with cost incurrence. The pipelines entered into take-or-pay contracts to serve their firm customers' anticipated demand for gas. Accordingly, those customers' subsequent reduced demands for gas have caused the incurrence of the pipelines' take-or-pay costs. Other potential allocation methods do not match cost causation with cost incurrence as well as the purchase deficiency method because they are related solely to current demand levels or purchases and shipments of gas.

Tennessee Gas Pipeline. Under the Commission's final orders on Tennessee's settlement proposal, Tennessee is to absorb 50% of the payments it makes to producers to settle its take-or-pay liability, and the remainder is to be passed through to its customers according to the purchase-deficiency method of allocation. In applying that method, the Commission established the base period (prior to the sharp decrease in customer demand for Tennessee's gas) as 1981-1982, and the deficiency period (when the declines took place) as 1983-1986. Each customer's purchase deficiency, and thus its responsibility for a portion of the take-or-pay costs incurred by Tennessee, is calculated by comparing its purchases in the deficiency period with its purchases in the base period. App., *infra*, 4a-5a, 84a-87a, 90a-93a, 122a-124a.[7] Tennessee's customers may either

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[7] Tennessee initially proposed to absorb only 20% of its take-or-pay costs. The administrative law judge recommended that the proposal be modified so that Tennessee would absorb 50% of the costs and pass through the remainder to its customers. App., *infra*, 28a-29a. After the Commission issued Order No. 500, Tennessee filed a settlement proposal that generally tracked that Order. In its February 8, 1988, decision on review of the ALJ's decision, *id.* at 26a-66a, the Commission adopted the 50-50 division but approved a method for allocating costs among Tennessee's customers that departed from Order No. 500: the cost of buying out take-or-pay liabilities that had already accrued was to be allocated under a modified version of the purchase-deficiency method, while the cost of buying down (reforming) uneconomical contract provisions on a prospective basis was to be allocated based on the maximum amount Tennessee was obligated to deliver to the customer as of January 1, 1986. *Id.* at 28a, 30a, 46a-49a. In its May 27, 1988, order on rehearing, *id.* at 67a-108a, the Commission modified the formula to allocate the entire passthrough amount using the purchase-deficiency method. The Commission explained that since Order No. 500 was issued, it had approved four other proposals that allocated costs to customers under the purchase-deficiency method, and it found no sufficient basis to depart from that approach here. *Id.* at 82a-91a, 122a-124a.

pay this direct charge over a period of several years of current gas service or discharge their liability in a lump sum payment to Tennessee. *Id.* at 113a-114a, 130a-131a. The Commission also imposed a $650 million cap on Tennessee's recoveries from its customers. *Id.* at 39a-41a, 76a-81a.

The Commission rejected the contention by several of Tennessee's customers that because its order allocated take-or-pay costs among customers on the basis of past purchasing patterns, the order constituted "retroactive ratemaking" and therefore violated the filed rate doctrine. App., *infra*, 47a-49a, 94a. The Commission reasoned that its order does not impose a rate increase for gas already sold or permit Tennessee to recover past costs that should have been included in rates for a prior period. Instead, the Commission explained, the order prescribes an appropriate allocation of Tennessee's current settlement payments incurred in connection with current gas service, just as the costs of resolving any contract dispute are typically included in the pipeline's next rate filing. The Commission observed that "[i]f pipeline recovery of take-or-pay costs at the time they are paid were retroactive ratemaking merely because the costs relate back to some past event, a pipeline could never lawfully recover those costs under *any* rate treatment." *Id.* at 48a.[8]

2. A number of parties sought judicial review of the Commission's orders in the D.C. Circuit. Certain of Ten-

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[8] The Commission likewise rejected the retroactive-ratemaking objection in Order No. 500. There, it noted that Commission measures enabled pipeline customers to purchase gas from alternative sources at lower prices while pipelines accrued take-or-pay liability, and it found it "reasonable that the beneficiaries of Commission initiatives to increase competition in the natural gas industry should share in the transition costs which accompany the industry's restructuring." Order No. 500, FERC Stats. & Regs. at 30,787.

nessee's customers challenged the purchase-deficiency method of cost allocation on two grounds. First, they argued that allocation of responsibility for take-or-pay costs on the basis of past purchasing patterns violates the filed rate doctrine because it constitutes a retroactive change in rates without advance notice. Second, the customers argued that even if the filed rate doctrine is not violated, the purchase-deficiency mechanism is not "just and reasonable" within the meaning of Sections 4 and 5 of the NGA. The court held that the purchase-deficiency method violates the filed rate doctrine, App., *infra*, 6a-11a, and it therefore did not reach the question whether that method is "just and reasonable."

The court found it irrelevant for purposes of the filed rate doctrine that the Commission's orders allocate Tennessee's *current* costs (those incurred in its current buyout and buydown of take-or-pay liability), rather than *past* costs, and that the orders do so by a prospective increase in the filed rate.[9] In the court's view, the decisive question "is not which costs are 'current' and which are 'past.' Rather, the appropriate inquiry seeks to identify the purchase decisions to which the costs are attached." App., *infra*, 9a. Accordingly, the court held that costs could not be allocated among Tennessee's customers on the basis of their purchase decisions during the base period (1981-1982) and the deficiency period (1983-1986), which they could no longer change. In so ruling, the court ex-

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[9] Under traditional ratemaking principles and Commission rulings, pipelines could not have charged their customers for take-or-pay liability as it accrued; only when the costs were incurred, through payment or settlement, could the costs be passed on. See Order No. 410, 44 F.P.C. 1142, 1143 (1970), aff'd *sub nom. Public Service Comm'n* v. *FPC*, 467 F.2d 361, 370 (D.C. Cir. 1972); *Panhandle Eastern Pipe Line Co.*, 32 F.E.R.C. ¶ 63,085, at 65,303 (1985).

pressed the view that "[p]roviding the necessary predictability is the whole purpose of the well established 'filed rate doctrine'." *Id.* at 10a (citations omitted). In a related vein, the court also concluded that Tennessee's customers did not have sufficient notice (at least prior to publication of Order No. 380 in June 1984) that they might later have to pay rates based in part on their purchases during that period. App., *infra*, 9a-10a.[10]

3. Petitions for rehearing en banc filed by the Commission and numerous other parties were denied by the court of appeals, with Chief Judge Wald and Judges Mikva and Edwards dissenting. App., *infra*, 137a-142a. In a statement on behalf of the three dissenters, Chief Judge Wald pointed out that the conversion provisions of Order No. 436 had enabled many customers to avoid their obligations to purchase a specified amount of gas from pipelines, and that, because those customers took advantage of the open-access regulatory regime to purchase gas elsewhere, they were responsible for the pipelines' accrual of

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[10] The court of appeals also addressed several other issues. First, ruling in the Commission's favor, it held that a pipeline's payments to a producer to buy out or buy down take-or-pay costs are not subject to the price ceiling in the NGPA. App., *infra*, 12a-17a. Second, the court held that the Commission should have either ordered that two customers be given credit for amounts they paid in prior settlements of their liability for certain of Tennessee's take-or-pay costs, or explained more completely its refusal to do so. *Id.* at 17a-23a. The court declined to resolve two other issues—whether the Commission should limit take-or-pay costs of sales subject to its jurisdiction pursuant to Section 5(a) of the NGA, and whether the March 31, 1989, sunset date for allocating take-or-pay liability is arbitrary and capricious—because those issues are raised on judicial review of Order No. 500 in the *AGA* case, which was (and is again) pending in the D.C. Circuit (see note 3, *supra*). App., *infra*, 23a-24a.

take-or-pay liability. App., *infra*, 141a-142a. She continued (*id.* at 141a):

> The FERC, then, did not "revise" these rates; circumstances subsequent to the signing of the contracts between the consumers and the pipelines altered the deal —and, in effect, the rate—originally agreed to by the consumers. The FERC's decision to reallocate some of these current costs did not violate the filed rate doctrine because the deal originally agreed to by the consumers had already been abrogated by the FERC. Neither the purchase decisions to which the consumers' original costs were attached nor the rates pursuant to them were still valid. It was a brand new world: there were no "old rates" to change.

The dissenting judges further observed that "[i]n a time when the structure of the natural gas industry is undergoing a sea change, the FERC must be granted considerable discretion to ensure that the transition period is handled in a manner that minimizes the disruption in the industry." App., *infra*, 141a. Indeed, they noted that in remanding Order No. 436, the D.C. Circuit in *AGD I* instructed the Commission "to do something about the pervasive take-or-pay contracts" that "hindered" pipelines from moving to open-access status, and in their view, Order No. 500 was "a good faith, and not unreasonable, response to the mandate." *Id.* at 141a-142a. By contrast, "[t]he panel's overly rigid interpretation of the filed rate doctrine * * * leaves the FERC essentially powerless to take care of the take-or-pay crisis," because a pipeline's prices would increase to a non-competitive level if take-or-pay costs were added as a surcharge to future sales, and even if some costs could be passed on in this manner, "that would still mean that total losses would be allocated *in*equitably." *Id.* at 142a. For these reasons, the dissenting judges concluded that the panel's decision will have a "significant effect * * * on the functioning of the industry and on the FERC's ability to regulate this 'quiet revolution' in the gas industry." *Ibid.*

REASONS FOR GRANTING THE PETITION

The court of appeals has invalidated a central feature of the policy adopted by the Federal Energy Regulatory Commission to resolve the problem of "take-or-pay" contracts that has pervaded the natural gas industry for a number of years. The court has done so, moreover, by adopting a view of the "filed rate doctrine" that is divorced from the text and purposes of the relevant provisions of the Natural Gas Act and from this Court's explanation of those provisions and the filed rate doctrine in *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571 (1981). As a result, the court has expanded the doctrine well beyond its traditional bounds to impose rigid limitations on the allocation of concededly current costs, a subject that heretofore has been governed by the necessarily flexible principles embodied in the "just and reasonable" standard of rate regulation. The court also subordinated cardinal principles of regulation under the just and reasonable standard that seek to assign cost responsibility among customers based on cost incurrence. The decision below therefore raises fundamental and far-reaching questions, not previously considered by this Court, regarding the rights and obligations imposed upon the Commission and other agencies, as well as the entities they regulate, by the statutory provisions that embody the filed rate doctrine.

The decision below also is of enormous practical importance. The "equitable sharing" policy adopted by the Commission to spread the cost of resolving the take-or-pay crisis over all segments of the natural gas industry has thus far proven to be quite successful, resulting in the settling of approximately $44 billion of the pipelines' present and future take-or-pay exposure and other related relief at a cost to the pipelines of approximately $9 billion. Of that $9 billion, almost $3.4 billion has been passed through to pipeline customers under the purchase-deficiency method of allocation. If the decision below is permitted to stand, much of this passthrough will have to be undone, and the

Commission will have to conduct still further proceedings in this case and many others, as well as its generic Orders Nos. 500-H and 500-I, to come up with and institute another means of allocating take-or-pay costs among pipeline customers. During such proceedings, the problem of take-or-pay liability will continue to pervade the relationship between pipelines and their customers, and thereby disrupt and delay a smooth transition to the truly competitive market Congress intended when it enacted the Natural Gas Policy Act of 1978 and the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, 103 Stat. 157. An appellate decision so far-reaching and disruptive in its effect, and so unsupported by legal precedent, should not go unreviewed by this Court.

1. In announcing its expansive view of the filed rate doctrine, the court below fundamentally misapplied the governing statutory provisions and ignored its duty under *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. 837 (1984), to defer to the reasonable interpretation of those provisions by the Commission.

a. The court of appeals invalidated the Commission orders at issue here without even discussing the terms of the statutory provisions under which they were issued, Sections 4 and 5 of the Natural Gas Act (NGA), 15 U.S.C. 717c and 717d. See App., *infra*, 6a-11a. The court proceeded instead as if the "filed rate doctrine" were a *judicially* fashioned rule that can be expanded by the courts in a common-law manner, according to their own perception of its underlying "purposes." In fact, however, the term "filed rate doctrine" is merely a label attached to a set of statutory provisions in the NGA and similar Acts of Congress that prescribe the procedures and substantive standards to be followed in setting rates and the effect that such rates must be given by the courts and others. The court below therefore should have grounded its analysis in the statutory provisions through which *Congress* articulated the particular rules that comprise what has come to

be known as the "filed rate doctrine." The Commission's orders in this case are fully consistent with the text and purposes of those provisions.

As relevant here, the filed rate doctrine is principally embodied in Section 4 of the NGA. Section 4(a) provides that all charges made or received by a natural gas company, and all rules and regulations affecting such rates or charges, shall be "just and reasonable," and any rate or charge that is not just and reasonable is deemed unlawful. Section 4(c) requires every natural gas company to file with the Commission "schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission," the classifications, practices, and regulations affecting such rates and charges, and contracts affecting rates, charges, classifications and services. Section 4(d) provides that unless the Commission otherwise orders, no change shall be made by a gas company in any rate, charge, classification or service, except after 30 days' notice to the Commission and the public.

These requirements were fully met here. First, the court of appeals did not question that the purchase-deficiency method of allocating take-or-pay costs among a pipeline's customers satisfies the "just and reasonable" standard of Section 4(a). Second, Tennessee Pipeline complied with Section 4(c) by filing tariffs with the Commission that set forth its proposed allocation method; those tariffs were modified by the Commission pursuant to Section 5(a), and Tennessee filed new tariffs to implement the rates on a prospective basis. Third, Tennessee is in full compliance with Section 4(d) because it is collecting only those rates that have been filed with and approved by the Commission.

The legislative history of the NGA does not elaborate upon these provisions of Section 4, and therefore does not suggest that they should be construed to impose further restrictions not specified in the text of the Act itself. See H.R. Rep. No. 709, 75th Cong., 1st Sess. 4-5 (1937); S. Rep. No. 1162, 75th Cong., 1st Sess. 4 (1937). Nor is there

any such suggestion in this Court's articulation in *Arkla* of the principles embodied in these statutory provisions: (1) rates filed with the Commission are lawful only if they are just and reasonable; (2) the authority to determine whether rates are just and reasonable is vested in the Commission; (3) no court may substitute its judgment for that of the Commission on the justness and reasonableness of rates; (4) "the right to a reasonable rate is the right to the rate which the Commission files or fixes" (quoting *Montana-Dakota*, 341 U.S. at 251); and (5) except where the Commission permits a waiver, "no regulated seller of natural gas may collect a rate other than the one filed with the Commission" (citing § 4(d)). 453 U.S. at 577. The Court explained that "[t]hese straightforward principles underlie the 'filed rate doctrine,' which forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority." *Ibid.* The Commission fully respected these "straightforward principles" here; and Tennessee did nothing that the doctrine resting on these principles "forbids," since it charged only rates that were "properly filed" with the Commission.

Finally, the Commission's orders comport with what *Arkla* identified as the underlying purposes of the filed rate doctrine: "preservation of the agency's primary jurisdiction over reasonableness of rates and the need to insure that regulated companies charge only those rates of which the agency has been made cognizant." 453 U.S. at 577-578 (quoting *City of Cleveland* v. *FPC*, 525 F.2d 845, 854 (D.C. Cir. 1976)). See also *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953, 963 (1986) (the doctrine is "a rule of administrative law designed to ensure that federal courts respect the decisions of federal administrative agencies"). Here, there was no interference with the primary jurisdiction of the Commission (since it reviewed Tennessee's proposed rates), and the Commission obviously was "made cognizant" of those rates.[11]

[11] In *Arkla*, the Court held that, under governing preemption principles, the provisions of the NGA that comprise the filed rate doctrine

b. The court of appeals nevertheless believed that the Commission's orders violate the filed rate doctrine because, in its view, they impose a retroactive rate increase on Tennessee's customers. App., *infra*, 9a-11a. This conclusion likewise is not rooted in the relevant statutory provisions. The prohibition against retroactive ratemaking derives from Sections 4(d) and 5(a) of the NGA. Section 4(d) essentially requires a pipeline to charge the rates it has filed with the Commission and prohibits it from changing its rates without giving 30 days' notice to the Commission and the public (except where the Commission waives the latter requirement for good cause shown). As we have explained, Tennessee fully complied with these requirements. Section 5(a) provides that when the Commission finds a gas company's rate, practice or contract unreasonable, it "shall determine the just and reasonable rate, * * * practice, or contract to be *thereafter* observed and in force, and shall fix the same by order" (emphasis added). The Commission fully complied with this requirement because, after disapproving Tennessee's initial proposal, it fixed the rates and practices to be thereafter observed by Tennessee to recover a portion of its take-or-pay costs.

The Court explained in *Arkla* that Section 5(a) "bars the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate," and "prevents the Commission itself from imposing a rate increase for gas already sold," at least absent a waiver by the

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require state courts to give effect to rates filed with the Commission and to decisions of the Commission concerning those rates. In *Nantahala*, which arose under the parallel provisions of the Federal Power Act, 16 U.S.C. 824d, the Court similarly held that once the Commission sets the wholesale rate, a state commission is barred from concluding that that rate is not just and reasonable. Accord, *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354, 371-372 (1988). Questions concerning the effect to be given Commission decisions pursuant to the federal statutory provisions comprising the filed rate doctrine in the preemption context are not presented in this case, which involves a challenge to the actions of the Commission itself, not those of a state court or agency in a proceeding under state law.

Commission. 453 U.S. at 578 & n.8. But the Commission did neither of those things here: it did not retroactively substitute a higher rate for the one previously charged by Tennessee for past services, and it did not order Tennessee's customers to pay a higher price for gas they actually purchased during either the base period (1981-1982) or the deficiency period (1983-1986). The Commission instead ordered customers to pay a new rate on a prospective basis to cover a portion of the costs of Tennessee's settlement of its take-or-pay exposure, and it allocated those current costs among Tennessee's customers on the basis of the relative amounts of gas they did *not* purchase during the deficiency period.

The purpose of allocating take-or-pay costs in this manner is not to punish the customers who decreased their purchases from Tennessee during the deficiency period. The purpose, rather, is the essentially remedial one of allocating the additional costs Tennessee has now incurred as a result of those purchasing patterns. For this reason, and contrary to the court of appeals' belief, the fact that Tennessee's customers had a legal right to purchase gas elsewhere during the deficiency period does not *absolutely* preclude the Commission from taking these past purchasing patterns into account in fashioning an appropriate method for allocating current take-or-pay liability. That instead is one factor to be considered by the Commission in determining whether Tennessee's rates and practices for recovering a portion of its take-or-pay costs are "just and reasonable" —the central regulatory standard under the Act.

Applying that standard, the Commission permissibly concluded that the customers who caused Tennessee to accrue take-or-pay exposure by reducing their purchases should contribute proportionately to meeting a portion of the costs incurred by Tennessee in settling its liability. After all, Tennessee agreed to the take-or-pay clauses in order to assure a source of supply for the gas it expected those customers to purchase under the then-existing regulatory regime. See note 6, *supra*. Moreover, the purchase-

deficiency method of cost allocation serves the broader regulatory principle, consistently followed by the Commission and approved by the courts under the "just and reasonable" standard, of matching rates with responsibility for the underlying costs. See *Cities of Riverside and Colton* v. *FERC*, 765 F.2d 434, 439 (5th Cir. 1985); *Public Systems* v. *FERC*, 709 F.2d 73, 76 (D.C. Cir. 1983); *Alabama Electric Cooperative, Inc.* v. *FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982). The court of appeals therefore improperly utilized a rigid, judicially fashioned version of the filed rate doctrine to intrude upon the Commission's discretion under the statutory "just and reasonable" standard "to devise methods of regulation equitably reconciling diverse and conflicting interests." *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968).

c. The court of appeals rejected the straightforward view of the filed rate doctrine as embodied in the relevant statutory provisions, as well as the compelling considerations underlying the Commission's regulatory approach in this case, on the ground that whether costs are "current" or "past" is not significant; rather, in its view, the critical inquiry concerns the "purchase decisions to which the costs are attached," since "[p]roviding the necessary predictability is the whole purpose of the * * * filed rate doctrine." App., *infra*, 9a, 10a. Apparently, the court believed that if Tennessee's customers had been apprised before they made their past purchasing decisions that a future rate would be based on those decisions, the filed rate doctrine would have been satisfied. But this was to require the impossible.

Tennessee could not have included any potential costs associated with its take-or-pay exposure in an earlier rate filing because it did not actually pay any monies to producers in settlement of that exposure—and therefore did not actually incur any costs—until shortly before its rate filing here. See note 9, *supra*. As a result, this is not a case in which "[t]he company having initially filed the rates and either collected an illegal return or failed to collect a suffi-

cient one must, under the theory of the Act, shoulder the hazards incident to its action including not only the refund of any illegal gain but also its losses where its filed rate is found to be inadequate." *FPC* v. *Tennessee Gas Co.*, 371 U.S. 145, 153 (1962). To the contrary, Tennessee sought to collect an entirely new charge to recover *current* costs, based on circumstances that were dramatically different from those in existence when its earlier rates were on file.

Whatever role the "predictability" notion properly may play in construing the statutory provisions that embody the filed rate doctrine, the court below erred in relying on that notion to extend the scope of the filed rate doctrine so as to prohibit Commission actions that are fully consistent with the governing statutory provisions themselves.[12] Moreover, the court's notion of predictability in this context is based on the unrealistic assumption that clear purchasing choices always exist, and that customers can freely move from one pipeline system to another to avoid the payment of prudently incurred costs. Prior to open access, a customer's major purchasing decision was made when it signed a firm service sales contract with a pipeline. As a result, each pipeline's array of customers remained fairly constant, and the pipeline exercised its NGA author-

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[12] This Court in *Arkla* did not suggest that predictability for customers is, in itself, an enforceable tenet of the filed rate doctrine, especially where, as here, the requirements of the relevant statutory provisions have been satisfied. The notion of predictability was first articulated by the D.C. Circuit in *Electrical District No. 1* v. *FERC*, 774 F.2d 490, 492-493 (1985). In *Electrical District*, however, the court held only that the Commission failed to comply with the requirement under Section 206(a) of the Federal Power Act, 16 U.S.C. 824e(a) (which is identical for present purposes to Section 5(a) of the NGA), to make a new rate prospective, because it permitted the utility to collect the new rate as of a date prior to the Commission's acceptance of the utility's compliance filing. Thus, *Electrical District* relied on the predictability notion in construing the express terms of the statute. It did not suggest that a court may rely on its own perceptions of the importance of predictability to extend the filed rate doctrine in a manner divorced from the statutory text.

ity to file rate increases for recovery of newly incurred costs.

As the court below acknowledged, the Commission often utilizes "accurate historical data" in exercising its authority under Sections 4 and 5 of the NGA. See App., *infra*, 8a.[13] For example, in *City of Willcox* v. *FPC*, 567 F.2d 394, 408-412 (1977), cert. denied, 434 U.S. 1012 (1978), the D.C. Circuit endorsed the use, for the allocation of scarce supplies of natural gas, of base periods precisely like those at issue in this case. The court of appeals recognized as much, but sought to distinguish *City of Willcox* on the ground that a "curtailment plan is not a *rate* change." App., *infra*, 7a, 10a. This asserted distinction is unfounded. Section 4(d) of the NGA applies not only to rates, but also to "classifications" and "services," which include curtailment plans. A curtailment plan therefore is governed by the same statutory principles that comprise the rate doctrine. See also *Nantahala*, 476 U.S. at 966 ("the filed rate doctrine is not limited to rates *per se*").

The court below also erred in rejecting the Commission's reliance on the precedent of minimum bills, which likewise involve fixed charges that are not based on current or future takes of natural gas. The court acknowledged that in *Atlantic Seaboard Corp.* v. *FERC*, 404 F.2d 1268, 1269-1270 (D.C. Cir. 1968), it affirmed a minimum bill that was created through the use of a base period prior to the date on which the buyer commenced purchasing from another source—virtually the same type of base utilized here—but it sought to downplay that similarity by observing that the "charge was avoidable simply by keep-

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[13] The Commission's regulations require pipelines to submit with their rate-change applications data "based upon a test period which shall consist of a base period of 12 consecutive months of most recently available actual experience, adjusted for changes in revenues and costs which are known and are measurable with reasonable accuracy at the time of the filing * * *." 18 C.F.R. 154.63(e)(2).

ing takes above the minimum bill volume." App., *infra*, 11a. The true comparison, however, is that both *Atlantic Seaboard* and the instant case dealt with fixed charges based upon *past* purchasing practices, not with a true sales commodity rate. The court of appeals thus converted predictability into a principle of cost avoidance, which has no grounding in the relevant statutory provisions and which in this case clashes with other basic precepts of utility ratemaking.[14]

d. As we have explained, nothing in Sections 4 and 5 of the NGA imposes the rigid limitation on the Commission's allocation of current take-or-pay costs that the court of appeals announced in this case. Accordingly, because the purchase-deficiency method of allocation is consistent with the basic "just and reasonable" standard under the NGA, it is permitted by the Act. However, if the court of appeals believed that Sections 4 and 5 of the NGA are ambiguous in this regard, it should have deferred, under *Chevron*, 467 U.S. at 842-845, to the Commission's reasonable interpretation of those provisions as not imposing an absolute prohibition against the purchase-deficiency method of allocation. See also *PBGC* v. *LTV Corp.*, No.

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[14] The court of appeals apparently was also concerned that past customers who did not currently buy gas from Tennessee might have to pay their share of take-or-pay liability, although the court expressly declined to rest its decision on that ground. App., *infra*, 9a, 11a n.1. It is undisputed, however, that no customers of Tennessee who were assessed take-or-pay liability had left the system, and the Commission has informed us that, as a general matter, relatively few customers have abandoned all service obligations with their pipeline suppliers. If any customer of an interstate pipeline did abandon its service obligations before the pipeline sought to pass through take-or-pay costs, it is not assessed any liability. But where a downstream pipeline customer did not abandon those obligations prior to the upstream pipeline's filing of take-or-pay passthrough tariff sheets, the Commission, in allocating costs in a just and reasonable manner, has required abandoning downstream pipeline customers to share in the payment of the take-or-pay liabilities to which they contributed. See *United Gas Pipe Line Co.*, 47 F.E.R.C. ¶ 61,163 (1989).

89-390 (June 18, 1990), slip op. 12-17. Yet the court of appeals did not even mention this principle. Such deference is especially appropriate here, because the Commission must balance the impact on various customers of Tennessee against other statutory policies, including those favoring a competitive market and the policy consistently followed by the Commission and endorsed by the courts of allocating costs to those who caused them to be incurred.

2. For a number of reasons, the erroneous ruling by the court of appeals warrants review by this Court.

a. The decision below is not an isolated misapplication of the statutory provisions that comprise the filed rate doctrine. Since the decision was rendered, the D.C. Circuit has applied its novel and expansive view of the filed rate doctrine to invalidate other Commission orders that were designed to allocate costs in a just and reasonable manner during periods of transition experienced by natural gas pipelines. See *Public Utilities Comm'n* v. *FERC*, 894 F.2d 1373, 1382-1383 (D.C. Cir. 1990); *Transwestern Pipeline Co.* v. *FERC*, 897 F.2d 570, 576-581 (D.C. Cir. 1990); see also *Columbia Gas Transmission Corp.* v. *FERC*, 895 F.2d 791, 793-795 (D.C. Cir. 1990).[15] The view of the filed

[15] In *Transwestern*, the court appeared to recognize the flaws in relying on predictability as an independent standard for reviewing Commission orders. The court stated that its suggestion in prior decisions, including the instant case, that "a rate violates the filed rate doctrine because a customer cannot respond in some way that enables it to escape the charge" was "clearly inconsistent" with the Commission's power to permit a pipeline to change its rates under Section 4(d), even though customers cannot avoid the charges unless they undertake "the elaborate process of securing abandonment under § 7 of the Act." 897 F.2d at 579. The court nevertheless denied rehearing en banc in the instant case just one week later.

rate doctrine adopted by the D.C. Circuit in these cases is of nationwide significance and particular concern, because any party may seek review of any Commission order in that court. See 15 U.S.C. 717r(a).

b. The decision below seriously undermines the Commission's efforts to deal with the take-or-pay problem in a just and reasonable manner. The Commission's "equitable sharing" policy serves to spread the costs of resolving that problem over all segments of the industry. The purchase-deficiency method of allocating costs among pipeline customers — and the closely related provisions of Order No. 500-H that are designed to resolve the take-or-pay problem without extensive proceedings regarding the prudence of those costs (see note 5, *supra*) — are essential features of this policy, because they seek to match cost responsibility with cost incurrence and to ensure that the transition from pervasive governmental intervention in the natural gas market to greater reliance on market forces will be accomplished in an equitable fashion and with reasonable dispatch.

By contrast, the court of appeals' rejection of the purchase-deficiency method, if allowed to stand, would have a number of adverse consequences: (1) it would cause the Commission to depart from the accepted principle of cost responsibility, because other potentially available alternatives (*e.g.*, the volumetric surcharge and contract demand methods [16]) are not based on that principle; (2) it would unfairly burden those LDCs and other customers that were captives of the pipeline when other customers were able to buy cheaper gas elsewhere; (3) it would create

[16] The contract demand method would allocate take-or-pay liability on the basis of the amount of gas a customer is entitled to demand under its contract with a pipeline, irrespective of how much gas the customer actually purchases.

an incentive for customers who are able to do so to leave Tennessee and other systems that have substantial take-or-pay exposure in order to avoid the higher prices that would be imposed under alternative allocation methods, thereby exacerbating the take-or-pay problem; and (4) it would preserve distortions in the current market by misallocating costs resulting from past purchasing decisions. The dimension of these impacts is demonstrated by the amount of money at stake. Pipelines have already passed through to their customers under the purchase-deficiency method approximately $3.4 billion in costs they have incurred in buying out or buying down take-or-pay liability, and this case alone involves the allocation of $650 million in such liability.

The Commission has been struggling with the take-or-pay issue for some time in the context of the transition to a truly competitive market for natural gas, and the courts have kept prodding it to take action. Indeed, it was the D.C. Circuit, in *AGD I*, that most prominently faulted the Commission for not addressing the take-or-pay issue (in connection with Order No. 436, which approved the open-access policy for pipelines), and it was *AGD I* that led to the Commission's approach in Order No. 500 and here. Similarly, in another major case, the Fifth Circuit invalidated the Commission's Order No. 451, which set a higher price ceiling for "old" gas, in part because the Commission had not first resolved the pipelines' take-or-pay problems. *Mobil Oil Exploration & Producing Southeast, Inc. v. FERC*, 885 F.2d 209, 223-224 (1989), cert. granted, No. 89-1453 (June 4, 1990). Yet if the decision below is permitted to stand, uncertainties generated by those problems will continue to pervade the industry and hinder the Commission's regulatory efforts while it undertakes further proceedings on the allocation of take-or-pay costs.

c. Finally, the purchase-deficiency approach is both a logical outgrowth and an integral part of the major trans-

formation of the natural gas industry that Congress, the Commission, and market forces have wrought over the past 12 years. That method of cost allocation serves to reduce the windfall that certain pipeline customers would otherwise realize by virtue of their having been in a position to take advantage of some steps in that transformation (the elimination of minimum billing practices) by switching to cheaper sources of natural gas. If this particular component of the Commission's efforts to provide for a fair transition to a restructured and competitive natural gas market is struck down, the overall transition will be infected with a substantial inequity.

The legislative history of the Wellhead Decontrol Act of 1989, which lifted price controls on wellhead sales of "old" gas beginning in January 1993, discusses with approval the various Commission measures, including Orders Nos. 436 and 500, that were designed to bring about a more competitive market for natural gas and that made appropriate the enactment of the Wellhead Decontrol Act. See S. Rep. No. 38, 101st Cong., 1st Sess. 5 (1989); H.R. Rep. No. 29, 101st Cong., 1st Sess. 6 (1989). Because the D.C. Circuit's decision here effectively invalidates a central feature of Order No. 500, it eliminates one of the regulatory premises on which Congress acted in removing the last statutory obstacle to a fully competitive natural gas market by lifting controls on "old" gas. The Court should grant certiorari because the decision below invalidates a significant administrative measure undergirding the legislatively mandated transition to a competitive market.

CONCLUSION

The petition for a writ of certiorari should be granted.
Respectfully submitted.

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U.S. GOVERNMENT PRINTING OFFICE: 1990—262-203/00951

Nos. 89-1988, 89-1989, 89-1990, 89-2000, 89-2016

Supreme Court, U.S.
FILED
AUG 31 1990
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

THE BERKSHIRE GAS CO., *et al.*, *Petitioners*,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*

TENNESSEE SMALL GENERAL SERVICE CUSTOMER GROUP, *et al.*, *Petitioners*,

v.

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TENNESSEE GAS PIPELINE COMPANY, *Petitioner*,

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NATIONAL FUEL GAS SUPPLY CORPORATION, *Petitioner*,

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FEDERAL ENERGY REGULATORY COMMISSION, *Petitioner*,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission has the power, under the Natural Gas Act, 15 U.S.C. § 717 *et seq.*, to impose on the customers of a natural gas pipeline a surcharge, based on each customer's gas purchases in earlier years, in addition to the rates and charges that were on file with the Commission when the purchases were made.

RULE 29.1 STATEMENT

Respondents Columbia Gas Transmission Corporation, Columbia Gas Distribution Companies, Inc., and The Inland Gas Company, Inc. are wholly-owned subsidiaries of The Columbia Gas System, Inc.

Respondents CNG Transmission Corporation and The Peoples Natural Gas Company are wholly-owned subsidiaries of The Consolidated Natural Gas Company.

Respondent Baltimore Gas and Electric Company has an affiliate: Safe Harbor Water Power Corporation.

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IN THE

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On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR RESPONDENTS IN OPPOSITION

STATEMENT

In 1988, the Federal Energy Regulatory Commission authorized Tennessee Gas Pipeline Company (Tennessee) to charge its customers up to an additional $650 million,

on the basis of the extent to which each customer's average annual purchases in 1983-86 declined from its average annual purchases in 1981-82. The charge to each customer was to be in addition to the rates and charges Tennessee had on file (and which were approved by the Commission) in 1981-86, and was computed without regard to the customer's current gas entitlement or gas purchases. The court of appeals invalidated this retroactive additional charge on the ground that it "violate[s] the filed rate doctrine as expressed in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578 (1981)." Pet. App. 11a.[1]

1. In the late 1970s and early 1980s, after several years of gas shortages and the deregulation of certain gas supplies by the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.*, many pipelines, including Tennessee, "enter[ed] into long-term contracts to purchase additional gas supplies at high prices and subject to high take-or-pay requirements."[2] Beginning about 1982, however, demand for gas fell as a result of rapidly increasing gas prices, declining oil prices, recession, warm weather, and other factors.[3] As a result, by late 1982, Tennessee's customers were purchasing less gas and Tennessee, like other major pipelines, was "confronted with an increasingly severe imbalance between the gas supplies deliverable to it under gas contracts . . . and the ability of its

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[1] "Pet. App." refers to the appendix to the petition for a writ of certiorari in *Tennessee Gas Pipeline Co. v. Associated Gas Distributors*, No. 89-1990 (filed June 21, 1990).

[2] Order No. 500-H, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, FERC Stats. & Regs., Regs. Preambles ¶ 30,867 at 31,509 (Dec. 13, 1989) (final rule). A "take-or-pay" contract provision requires a buyer of gas to pay for a specified minimum volume each year (generally 75-90% of the amount deliverable under the contract) whether or not it takes that much gas. If the buyer does not take the minimum volume, it must "prepay" for the remaining gas and may then "recoup" that gas over a specified future period after which recoupment rights may be forfeited.

[3] *See id.* at 31,510.

markets to absorb natural gas at Tennessee's current price levels." Tennessee April 29, 1983, letter to producers, Exhibit No. TMM-10 at 1, R. 4117 (*see* Appendix, *infra*, 1a).

By 1986, this imbalance forced Tennessee to initiate two kinds of strategies to extricate itself from its contracts. Tennessee sought to "buy out" its accumulated take-or-pay liabilities for gas not taken in past periods and to "reform" its purchase contracts to reduce or eliminate the continuing gap between its high contract prices and the lower current market prices of gas. *See Tennessee Gas Pipeline Co.*, 36 FERC ¶ 61,032 (1986).

According to Tennessee estimates later accepted by FERC, these costs were about one-third "buyout" costs and two-thirds "contract reformation" costs. It was estimated that by the end of 1985, Tennessee's accumulated take-or-pay liabilities were $1.75 billion and that these liabilities could be bought out at 20 cents on the dollar, or $350 million. *See* Pet. App. 115a-116a. It was estimated that at the end of 1985 the "present value of differences between contract prices and spot market prices under Tennessee's contracts totalled $1.5 billion" and that it would cost Tennessee 50 cents on the dollar, or an additional $750 million, to reform these contracts. *Id.* at 115a.

2. Respondents were direct and indirect customers of Tennessee in 1981-86.[4] FERC's orders in this case authorized Tennessee to collect a surcharge from its cus-

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[4] Respondents include interstate pipelines, other regulated sellers of natural gas, industrial and other gas end users, and state regulators and consumer advocates. Those respondents that are regulated entities have their own obligations, under federal and/or state law, to file rate schedules and to abide thereafter by their filed rates. All of the respondents make decisions concerning gas purchases, including choices between alternative suppliers or between natural gas and alternative fuels, based on the information contained in their vendors' filed rate schedules.

tomers for up to $650 million of the cost of extricating itself from its gas supply purchase contracts. But FERC's orders are not based on any factual finding that particular respondents either were responsible for or benefited from Tennessee's oversupply. To the contrary:

First, there has been no Commission determination of the extent to which Tennessee's own actions in entering into high-price take-or-pay contracts were "prudent." [5] And the Commission has never suggested that any customer induced Tennessee to enter into what later proved to be disastrous contracts.

Second, this case does not involve any breach of contract or violation of tariff by Tennessee's customers. The shorthand terms "deficiency period" (to refer to the years 1983-1986) and "deficiency" (to refer to a decline in a Tennessee customer's purchases between 1981-82 and 1983-86) refer simply to the decline in purchases by customers between the two past periods and should not be taken to imply that any customer that bought less gas in the 1983-86 period failed to comply with any of its obligations.

Tennessee's customers in 1981-86 were not obligated to purchase any specific amount of gas. They paid (i) a fixed "demand charge" based on their gas purchase entitlements (essentially a capacity reservation charge) and (ii) a "commodity charge" for the volumes of gas actually purchased. *See Tennessee Gas Pipeline Co. v. FERC*, 871 F.2d 1099, 1103 n.5 (D.C. Cir. 1989). They were also subject to a "minimum bill" tariff provision under which each Tennessee customer was required to pay Tennessee as if it had taken 66⅔ percent of its con-

[5] The Commission's administrative law judge found that Tennessee was prudent in incurring its take-or-pay obligations. *See* Pet. App. 70a. This finding was extensively challenged before the Commission, which has ruled that any Tennessee customer may pursue a challenge to Tennessee's prudence, but only at the risk of a higher eventual surcharge based on past purchases. *Id.* at 105a.

tract entitlement, even if it did not take that much gas. Insofar as is relevant here, the customers met all of their contract and minimum bill obligations.[6]

On June 1, 1984, nearly a year and a half into the later-defined "deficiency period," the Commission barred the inclusion of variable costs (primarily the cost of the gas itself) in pipeline minimum bills. Order No. 380, *Elimination of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions*, FERC Stats. & Regs., Regs. Preambles ¶ 30,571 (June 1, 1984). On a case-by-case basis, the Commission later barred pipeline minimum bills altogether, *see* Order No. 500-H, FERC Stats. & Regs. at 31,511, eliminating Tennessee's minimum bill effective August 1, 1987—well after the deficiency period was over. *Tennessee Gas Pipeline Co.*, 36 FERC ¶ 61,071, *reh'g*, 40 FERC ¶ 61,140 (1987).[7]

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[6] Petitioner Berkshire Gas Company's assertion (Pet. 8) that respondent Columbia Gas Transmission Corporation violated Tennessee's minimum bill is flatly wrong. Although Columbia did not take as much gas in 1983 as the minimum bill purportedly obligated it to pay for, Columbia had no obligation to take any quantity of gas. Columbia sought a waiver from the Commission of any minimum bill payments to Tennessee. That matter was resolved by a settlement under which Columbia and certain other customers, in lieu of the minimum bill, paid the fixed cost portion of the minimum bill and their proportionate share of Tennessee's take-or-pay liabilities to gas producers. *Columbia Gas Transmission Corp. v. Tennessee Gas Pipeline Co.*, 29 FERC ¶ 61,208 (1984), *reh'g*, 31 FERC ¶ 61,053 (1985). The terms of this settlement were extended, with modifications, through July 1984. *Columbia Gas Transmission Corp.*, 31 FERC ¶ 61,307 (1985), *reh'g*, 34 FERC ¶ 61,219 (1986). There is no basis whatever for Berkshire's implication that noncompliance by any customer with any contract provision was the cause of Tennessee's take-or-pay problem.

[7] On review of FERC's determination to eliminate its minimum bill as anticompetitive, Tennessee argued that the minimum bill was needed to reduce Tennessee's exposure on account of its take-or-pay liabilities to producers. This claim was rejected by the court of appeals. *Tennessee Gas Pipeline Co. v. FERC*, 871 F.2d 1099, 1106 (D.C. Cir. 1989).

FERC abolished minimum bills because it found they were "fundamentally inconsistent with the increasingly competitive wellhead market mandated by the Congress in 1978." Order No. 380, FERC Stats. & Regs. at 30,964. FERC noted that it "ha[d] encouraged regulated utilities to pursue least-cost [gas purchasing] strategies" and found that "the presence of variable costs in minimum commodity bills thwarts this policy." *Id.*

The record does not establish the extent to which those Tennessee customers that reduced their purchases in the 1983-1986 deficiency period did so because of (i) lower overall gas demand (due to factors such as reduced economic activity, higher energy prices, and conservation measures by residential and other users), (ii) switches by *their* customers to less expensive alternative fuels or alternative gas supplies, or (iii) the partial elimination of minimum bills in 1984. But three things are clear: First, even a customer that purchased its 66⅔ percent minimum bill quantities in 1983-86 could have a large "deficiency" compared to the 1981-82 period, when many of Tennessee's major customers were purchasing 100 percent of their contract entitlements. Second, to the extent that any Tennessee customer, partially freed from the minimum bill, bought lower cost gas elsewhere, it was doing exactly what the Commission had intended it to do.[8] Third, any reduction in purchases to (or below) minimum bill levels pursuant to the Commission's stated policies would be overwhelmingly punished by the surcharge the Commission would impose on purchase reductions during the 1983-1986 period.[9]

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[8] During this same time, state regulators were also enforcing least-cost purchasing policies in approving retail rates for gas service. *See, e.g., Kentucky West Virginia Gas Co. v. Pennsylvania Pub. Utils. Comm'n*, 837 F.2d 600 (3d Cir.), *cert. denied*, 488 U.S. 941 (1988).

[9] A Tennessee customer that shifted some of its 1983-86 purchases to another supplier who was offering slightly cheaper gas may well have realized a small savings. But for that effort to comply with

The Commission took a second regulatory step (which Chief Judge Wald later mistakenly claimed "let [Tennessee's customers] off the hook," Pet. App. 33a) that in fact had virtually nothing to do with declines in purchases by Tennessee's customers in 1983-86. On October 9, 1985, the Commission issued Order No. 436,[10] which created strong incentives for interstate pipelines to become "open access" transporters of gas, enabling customers connected to only one pipeline nevertheless to buy gas from suppliers other than the pipeline itself. Although revolutionary, Order No. 436 was not self-executing: Tennessee did not become an "open access" pipeline until December 1986, the last month of the "deficiency period." *See Tennessee Gas Pipeline Co.*, 38 FERC ¶ 61,004 (1987).[11]

3. On June 3, 1986, Tennessee filed a tariff change under section 4 of the Natural Gas Act (the Act), 15 U.S.C. § 717c. Anticipating that when it became an open access pipeline its gas costs under its contracts with producers would make its gas entirely uncompetitive, Tennessee announced an intention to renegotiate its producer contracts, paying producers to buy out past contract liabilities and to reform the price and other terms for the

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Commission policy and serve its own customers as cheaply as possible, the Tennessee customer has now been surprised with a surcharge equal to (i) its proportionate share of 50 percent of the *full* cost of buying out Tennessee's liability for gas not taken by Tennessee in 1983-86 and (ii) the same share of Tennessee's costs of reforming its high-price contracts so that Tennessee can *now*, and in the future, sell gas at market prices. As noted, these reformation costs, which have no relationship at all to purchase declines in 1983-86, are, according to estimates adopted by the Commission, two-thirds of Tennessee's costs involved in this case.

[10] *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, FERC Stats. & Regs., Regs. Preambles ¶ 30,665 (Oct. 9, 1985).

[11] In fact, under the FERC orders at issue, a Tennessee customer whose purchases began to decline only after Order No. 436 was implemented by Tennessee would bear none of the burden either of Tennessee's buyout costs or of its contract reformation costs.

future. To fund its renegotiation program, Tennessee sought Commission authority to bill directly to its customers (outside of normal demand charges and commodity sales rates) 80 percent of its buyout and reformation costs and proposed to absorb the remaining 20 percent.[12] On July 2, 1986, the Commission issued an order rejecting the tariff filing but setting the matter for hearing to enable Tennessee to make a factual record in support of the proposal.[13] *See* Pet. App. 95a-96a.

Meanwhile, in a 1985 policy statement, the Commission had reaffirmed its traditional policy that prudent buyout and reformation costs, associated with take-or-pay contracts prudently entered into, could be treated as gas supply costs and reflected in a pipeline's *current* sales commodity rates.[14] However, following a March 5, 1987, Proposed Policy Statement,[15] the Commission on August 7, 1987, issued Order No. 500[16] adopting a new policy, 18 C.F.R. § 2.104, that offered pipelines the opportunity

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[12] Tennessee also proposed to absorb all such costs paid to affiliated gas producers.

[13] *Tennessee Gas Pipeline Co.*, 36 FERC ¶ 61,032 (1986).

[14] *Regulatory Treatment of Payments Made in Lieu of Take-or-Pay Obligations*, FERC Stats. & Regs., Regs. Preambles ¶ 30,637 at 31,300 (Apr. 10, 1985) ("1985 Policy Statement"). The traditional policy is reflected in 18 C.F.R. § 2.104(a), which provides that "pursuant to existing Commission policy and practice . . . pipelines may pass through prudently incurred take-or-pay buyout and buydown [reformation] costs in their sales commodity rates." *See also*, Pet. App. 71a-72a; *Take-or-Pay Provisions in Gas Purchase Contracts: Statement of Policy*, FERC Stats. & Regs., Regs. Preambles ¶ 30,410 (Dec. 16, 1982).

[15] *Recovery of Take-or-Pay Buy-out and Buy-down Costs by Interstate Natural Gas Pipelines*, 38 FERC ¶ 61,230 (1987).

[16] *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, FERC Stats. & Regs., Regs. Preambles ¶ 30,761 (Aug. 7, 1987) (interim rule). Order No. 500 was remanded to the Commission in *American Gas Ass'n v. FERC*, 888 F.2d 136 (D.C. Cir. 1989) (*AGA*). In response to *AGA*, the Commission issued Order No. 500-H on December 13, 1989, and Order No. 500-I on February 12, 1990 (FERC Stats. & Regs., Regs. Preambles ¶ 30,880). Challenges

to elect an alternative recovery mechanism. A qualifying pipeline that agreed to absorb at least 25 percent of its buyout and reformation costs would be authorized to recover an equivalent amount of costs (up to 50 percent of its total) through a "fixed charge." FERC stated those fixed charges would be allocated to customers in proportion to their purchase reductions during a past deficiency period, with any remaining unabsorbed portion (up to 50 percent for a pipeline seeking fixed charge recovery of only 25 percent) recovered through a prospective "volumetric surcharge" on both gas sales and gas transportation. Order No. 500, FERC Stats. & Regs. at 30,787.

4. On July 9, 1987, a FERC administrative law judge followed FERC's March 5, 1987, Proposed Policy Statement, and ruled that Tennessee's direct-bill tariff should be allowed if it agreed to absorb 50 percent of its buyout and reformation costs. Pet. App. 80a.

On October 14, 1987, while an appeal was pending from the administrative law judge's order, Tennessee filed a proposed Stipulation and Agreement by which it proposed to recover, through fixed "demand surcharges," 50 percent of its buyout and reformation costs relating to its take-or-pay contracts, subject to an overall cap of $750 million. Consistent with its prior direct-bill proposal and the position it had taken in the administrative hearing, Tennessee proposed to allocate its take-or-pay buyout costs (which it estimated to be one-third of the total) under a complex formula that relied both on customers' respective annual entitlements under their current gas supply contracts and on three different measures

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to Order No. 500, as amended by these later orders, were heard by the D.C. Circuit on an expedited basis. On August 24, 1990, the D.C. Circuit upheld Order Nos. 500-H and 500-I, remanding two issues not relevant here. *American Gas Ass'n v. FERC*, Nos. 87-1588, slip op. at 6 (D.C. Cir., August 24, 1990). The court noted that the issues in the present case are before this Court on petitions for a writ of certiorari and did not discuss their merits. *Id.* at 44-45.

of past purchase "deficiencies." As to the costs attributed to reforming contracts for the future (estimated at two-thirds of the total), Tennessee proposed an allocation in proportion to customers' annual entitlements as of 1986 under their gas supply contracts. *See* Pet. App. 97a-98a.

On February 8, 1988, acting under section 5(a) of the Act, 15 U.S.C. § 717d(a), FERC reduced the recovery "cap" to $650 million, made other modifications, and then approved Tennessee's proposal. Pet. App. 94a-131a. FERC specifically approved Tennessee's proposed allocation of two-thirds of the costs to current customers in proportion to their contract entitlements, finding that "[t]he evidence substantiates Tennessee's expectations that ⅓ of its [subject] costs will relate to settlement of take-or-pay claims and ⅔ to contract reformation." *Id.* at 115a. The Commission expressly noted that "this allocation methodology deviates from Order No. 500, which would allocate all costs based on [past] purchase deficiencies." *Id.* at 113a.

In a May 27, 1988, order on rehearing, Pet. App. 132a-170a, the Commission, essentially without explanation and with no supporting record evidence, reversed its approval of Tennessee's cost-allocation methodology. *Id.* at 150a. FERC now required both buyout and reformation costs to be allocated solely on the basis of 1983-86 "deficiencies," declaring simply that "the allocation factors based on [contract entitlements] are unreasonable" and that "compliance with the cost incurrence principles based on past purchase deficiencies, as established in Order No. 500, is required to ensure the reasonable allocation of costs on Tennessee's system." [17] *Id.*

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[17] This February to May flip-flop by the Commission undercuts petitioners' repeated assertions that deficiency-based allocation of direct billing costs is the only "just and reasonable" recovery mechanism. Berkshire Pet. 4; Tenn. Small Cust. Group Pet. 7, 19-20. Contrary to Tennessee's assertion, Pet. 11, the court of appeals did not reach the issue of whether deficiency-based recovery is just and reasonable.

In its order on rehearing, FERC rejected the contention that "allocation of take-or-pay [buyout and contract reformation] costs cannot be based on customers' past purchase decisions and that to do so constitutes retroactive ratemaking." *Id.* at 157a. FERC said (*id.* at 158a):

> Costs that a pipeline will pay to buy out take-or-pay exposure, reform contracts, or reserve future deliveries are a current expense. These costs are merely being allocated on the basis of past purchase deficiencies, a methodology that links more closely current cost incurrence with cost causation. That this methodology relies on historical purchase data does not turn it into retroactive ratemaking.

5. On petitions for review, the court of appeals rejected this reasoning and vacated the Commission's orders. Pet. App. 1a-28a. The court agreed with challengers that the charges authorized by the Commission constituted a "retroactive change in rates without advance notice and therefore violate[d] the filed rate doctrine as expressed in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578 (1981)." *Id.* at 11a. The court noted that the effect of the Commission's orders was that Tennessee's customers "are expected to pay a surcharge, over and above the rates on file at the time of sale, for gas they had already purchased." *Id.* at 14a. The court added, "Indeed, the Commission now even forces past customers who no longer purchase *any* gas from Tennessee to pay their share of the take or pay liability." *Id.* at 13a (emphasis by the court).

The court of appeals rejected FERC's argument that because Tennessee was *currently* incurring the buyout and reformation charges, the Commission was not engaging in impermissible retroactive ratemaking when it authorized Tennessee to bill these charges to customers on the basis of past gas sales. Noting the importance of advance notice to customers of the costs of gas service, the court said, "the relevant question is not which costs

are 'current' and which are 'past.' Rather, the appropriate inquiry seeks to identify the purchase decisions to which the costs are attached." *Id.* The court agreed with challengers that, while the Commission may certainly use "historical data" in its ratemaking determinations, "the Commission may not impose a direct surcharge geared to past gas purchases." *Id.* at 12a.[18]

The full court of appeals, with three judges dissenting, denied rehearing *en banc.* Pet. App. 29a-34a. Judge Williams, a member of the panel, in voting to deny rehearing, rejected suggestions that the panel decision "represents a particularly aggressive application of the filed rate doctrine." *Id.* at 32a. To the contrary, he said: "The conclusion seems inescapable that as conceived by the Commission it is a charge for gas service in the 1983-86 period and as such violates the filed rate doctrine." *Id.* Chief Judge Wald, who was not a member of the panel, voted to rehear the case *en banc.* She stated, mistakenly, that FERC's "Order No. 436 . . . allowed [Tennessee's customers] to break [their] contracts prior to purchasing the amount of gas specified in the contracts." *Id.* at 33a. From this, she concluded that "FERC's decision to reallocate some of these current costs did not violate the filed rate doctrine because," as she mistakenly believed, "the deal originally agreed to by [Tennessee's customers] had already been abrogated by the FERC." *Id.*

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[18] The court also rejected an attempted distinction between a retroactive charge for gas taken and such a charge for gas not taken: "As a mathematical fact, the charge is as much a result of gas taken during the base period as it is of gas not taken during the deficiency period." Pet. App. 14a.

ARGUMENT

The Natural Gas Act "prevents the Commission itself from imposing a rate increase for gas already sold." *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578 (1981) (*Arkla*). FERC's orders in this case were in clear violation of that statutory rule. The D.C. Circuit's decision vacating those orders and remanding to FERC for consideration of lawful recovery mechanisms for Tennessee's buyout and reformation costs was plainly correct and does not warrant this Court's review.

The "restructuring of the natural gas industry" [19] is neither at issue nor at risk in this case: this case involves routine application of longstanding statutory rules for determining how a regulated entity's costs may be recovered through charges to customers. The "equity" and "practicality" arguments marshalled in support of FERC's orders are quite wrong, but even if it had equity on its side, FERC "does not have the power to adopt a policy that directly conflicts with its governing statute." *Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, No. 89-624, 110 S. Ct. 2759, 2770 (1990) (*Maislin*).[20]

1. The Act unambiguously bars FERC from ordering a pipeline to collect a surcharge for past gas service, over and above the rates it had on file when the service was provided. Any such order would also conflict with several decisions of this Court.

(a) Section 4(c) of the Act, 15 U.S.C. § 717c(c), requires a pipeline to file "schedules showing all rates and

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[19] *Associated Gas Distribs. v. FERC*, 824 F.2d 981, 993 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988), quoted at Comm. Pet. 7.

[20] *Maislin* arose under a different statute (the Interstate Commerce Act), and it involved agency action purporting to validate lower rates than those on file, rather than higher rates as in the present case. But the holding of that case is squarely on point: here, as there, the rate-regulating agency does not have the "authority to alter the well-established statutory filed rate requirements." 110 S. Ct. at 2770.

charges for any transportation or sale subject to the jurisdiction of the Commission." Tennessee had such rate schedules on file throughout the period 1981-1986 and the rates were approved by FERC.[21] This case concerns 1988 FERC orders that would *change* Tennessee's filed and FERC-approved rates for 1981-1986.

The plain words of the Act require rate changes to be prospective only. Section 4(d), 15 U.S.C. § 717c(d), permits a pipeline to change its filed rates only on thirty days notice, which is effected by filing "new schedules stating plainly the change . . . and the time when the change or changes *will* go into effect." *Id.* (emphasis added). The Commission may waive the thirty days' notice, but only by an order specifying "the time when [the changes] *shall* take effect." *Id.* (emphasis added). The only other way that rates can be changed is by a Commission finding under section 5 of the Act, 15 U.S.C. § 717d, that the filed rates are not just and reasonable, in which case "the Commission shall determine the just and reasonable rate . . . to be *thereafter* observed and in force." *Id.* (emphasis added).

These words of futurity are not an accident. When the Natural Gas Act was adopted, it was already well established that agency ratesetting powers are essentially legislative and that an agency is bound "not to repeal its

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[21] *See, e.g., Tennessee Gas Pipeline Co.*, 19 FERC ¶ 62,600 (1982) (approving uncontested settlement rates, November 1, 1981 through April 1, 1983); *Tennessee Gas Pipeline Co.*, 26 FERC ¶ 61,164 (1984) (approving uncontested settlement rates effective through August 3, 1983, and prospectively from August 4, 1983); *Tennessee Gas Pipeline Co.*, 34 FERC ¶ 61,277, *reh'g granted and order clarified*, 35 FERC ¶ 61,003 (1986) (approving interim settlement rates not subject to later surcharge, for February 1 through April 30, 1986); *Tennessee Gas Pipeline Co.*, 35 FERC ¶ 61,252, *reh'g denied*, 36 FERC ¶ 61,305 (1986) (extending interim rates until approval of pending settlement offer in Docket No. RP85-178); *Tennessee Gas Pipeline Co.*, 40 FERC ¶ 61,145 (1987) (approval of uncontested settlement offer in Docket No. RP85-178 as to rates effective in 1986 and 1987).

own enactment with retroactive effect." *Arizona Grocery Co. v. Atchison, T. & S.F. Ry. Co.*, 284 U.S. 370, 389 (1932) (Interstate Commerce Act).

(b) Consistent with *Arizona Grocery* and the statutory language, this Court has long held that FERC's only power, under section 5 of the Natural Gas Act and the corresponding provision of the Federal Power Act,[22] is to prescribe a new rate to take effect prospectively. FERC has no power "to grant reparations." *Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 254 (1951). The Commission's power "is limited to prescribing the rate 'to be thereafter observed' and thus can effect no change prior to the date of the order." *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956). "[T]he rate found by the Commission to be just and reasonable becomes effective prospectively only." *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378, 389 (1959).

It is equally clear that, except as permitted by its statutory refund authority (15 U.S.C. § 717c(e)), the Commission may not alter a rate retroactively pursuant to a pipeline rate filing under section 4. In *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. 145 (1962), the Court held that even if "a rate for one class or zone of customers [is] . . . found by the Commission to be too low, . . . the company cannot recoup its losses by making retroactive the higher rate subsequently allowed." *Id.* at 152-53. In *Arkla*, the Court gave clear instructions that neither the seller nor the Commission may retroactively increase a seller's filed rates for gas sold in a past period:

> In sum, the [Natural Gas] Act bars a regulated seller of natural gas from collecting a rate other

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[22] Section 206a, 16 U.S.C. § 824e. The Court has an "established practice of citing interchangeably decisions interpreting the pertinent sections of the two statutes." *Arkla*, 453 U.S. at 577 n.7.

> than the one filed with the Commission *and* prevents the Commission itself from imposing a rate increase for gas *already sold* . . . . [T]he ruling of the Louisiana Supreme Court . . . amounts to nothing less than the award of a retroactive rate increase . . . . This, [petitioners] contend, is precisely what the filed rate doctrine forbids. We agree.

453 U.S. at 578-79 (emphasis added).

2. The court of appeals ruled that Tennessee's "deficiency" charge ordered by FERC in 1988 was retroactive and thus barred by the filed rate doctrine. That ruling was clearly correct.

(a) The 1988 FERC-ordered "deficiency" charge is based solely on the extent to which a Tennessee customer's average annual gas purchases in 1983-1986 fell below its average annual purchases in 1981-1982. The customer's compliance with the rates and terms of service that *were* on file (and that had been approved by the Commission) in 1981-86 makes no difference. Even a 1981-86 customer who does not now buy, and is not now entitled to buy, any gas at all from Tennessee is liable for the surcharge if its purchases declined between the past "base period" and the past "deficiency period." [23] The surcharge is, pure and simple, an additional charge for past gas service.

In effect, FERC is now saying to Tennessee's customers: "You did not buy as much gas as Tennessee expected you to during 1983-1986, so we want you now to pay additional charges for the gas you did purchase."

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[23] According to the Commission, if a pipeline customer had terminated its relationship with Tennessee after 1986 but before Tennessee "sought to pass through take-or-pay costs, it is not assessed any liability." Comm. Pet. 26 n.14. But if a pipeline customer terminated its relationship with Tennessee after the Tennessee filing, FERC would require it "to share in the payment of take-or-pay liabilities." *Id.* It is obvious that the charge imposed on the latter customer is for *past* gas service.

But Tennessee's rates on file in 1981-86 were *not* contingent on a customer's maintaining through 1983-86 the same level of purchases it made as in 1981-1982, and neither Tennessee nor the Commission had the right in 1988 to turn the earlier rates into volume-based rates.

(b) Petitioners argue (Comm. Pet. 20; Tenn. Pet. 12) that the only reason why the Act requires rate changes to be filed first and to take effect prospectively is to assure that FERC is "cognizant" of the rates being charged. They suggest that what the Commission labels the " 'predictability' notion" (Comm. Pet. 24) is a mere caprice of the D.C. Circuit, and that Tennessee's "deficiency" charge was not retroactive because, after the Commission's orders in this case, Tennessee of course filed a new tariff containing the surcharge before actually billing its customers. *See* Comm. Pet. 19; Tenn. Pet. 13.

But the purpose of the filed rate doctrine is not merely to prevent utility charges from escaping FERC review. The central purpose is "to render rates definite and certain." *Arizona Grocery Co. v. Atchison, T. & S.F. Ry. Co.*, 284 U.S. at 384, *quoted in Maislin*, No. 89-624, 110 S. Ct. at 2766.[24] Tennessee is one of a chain of entities, each of which needs to know the basis on which it is currently being charged for service in order to make its own contracting and purchase decisions and, if a regulated entity, to make its own prospective rate filings with federal and state agencies. *See Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986); *Mississippi Power &*

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[24] As the D.C. Circuit explained in another recent FERC case:

> The rule against retroactive ratemaking . . . tends to make this highly regulated market approximate ordinary ones, where, for example, General Motors may not, after a sale, demand another $500 to cover its costs, and a buyer may not demand a refund because he just discovered that a competitor had been offering similar cars for less.

Public Utils. Comm'n v. FERC, 894 F.2d 1372, 1383 (D.C. Cir. 1990).

Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354 (1988). Since the Commission speaks in such apocalyptic terms about this case, it is not inappropriate to respond that the entire scheme of private, although regulated, gas and electric power transactions would be fundamentally changed if the Commission were free to determine, in hindsight, that filed prospective rates in past periods were not high enough and customers in those periods (including regulated utilities subject to their own filing obligations) should now be surcharged for their purchases during those past periods. The need for certainty in making decisions (and not merely preservation of FERC's jurisdiction) is why section 4(d) requires that notice of changes be given "to the public" (as well as the Commission) and why this Court has said that "the Commission itself has no power to alter a rate retroactively" or to "impos[e] a rate increase for gas already sold" (*Arkla*, 453 U.S. at 578).

The Commission cannot elude these requirements, and impose a retroactive additional charge on gas sold in 1981-86, by the mere formality of ordering a rate filing before the surcharge bills are sent out. As Judge Williams said below, "It is hard . . . to see how [the filed rate doctrine] would retain any force if the proposed purchase deficiency charge were allowed. It is virtually indistinguishable from the Commission's substituting in 1988 a new rate schedule for gas purchased in 1983-86." Pet. App. 32.

(c) The Commission acknowledges (Comm. Pet. 24) this Court's statement that a utility, having filed its rates, "must, under the theory of the Act, shoulder the hazards . . . including . . . its losses where the filed rate is found to be inadequate." *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. at 153. But here, FERC says, "Tennessee sought to collect an entirely new charge to recover *current* costs, based on circumstances that were dramatically different from those in existence when its earlier rates were on file." Comm. Pet. 24.

That argument is sheer sleight of hand. First, if FERC means to suggest that the costs came as a surprise, there is ample evidence that Tennessee knew by late 1982 that it had a significant problem.[25] More important, what makes the charges unlawfully retroactive is adding them, on top of the filed rates paid at the time, to the charge for gas service in a past period; FERC's insistence that the costs are "current" only reinforces the objection to assessing the charges solely on the basis of respondents' purchase decisions in 1981-86, which were based on Tennessee's filed tariffs during that past period.[26] And the fact that two thirds of the costs are being incurred today to reduce Tennessee's gas cost tomorrow makes it even more objectionable to impose the charges based on purchase decisions made yesterday.

(d) Petitioners,[27] and to some extent Chief Judge Wald in her dissent from the denial of rehearing *en banc*,[28] defend the "deficiency" charge on the ground that costs should be borne by the customers that "caused" them. But this argument misstates both the facts and the relevant principles of ratemaking.

Tennessee's claim to a surcharge is not based on any finding that the surcharged customers either (i) induced Tennessee to enter into "long-term contracts to purchase

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[25] *See* Pet. App. 62a-63a; 67a-69a; *see also* Appendix, *infra*.

[26] As Judge Williams said, "If current gas costs surged, for example, and the Commission responded by authorizing a surcharge on individual customers' 1984 takes, the violation of the filed rate doctrine would be plain." Pet. App. 31a. The ratemaking question whether it is proper to include particular costs in the rates for a particular period, *see, e.g., Public Serv. Co. of New Hampshire v. FERC*, 600 F.2d 944, 958 (D.C. Cir.), *cert. denied*, 444 U.S. 990 (1979), is entirely different from the present question, which is whether it is permissible to reset charges for gas sold in a prior period.

[27] Comm. Pet. 23-24; Tenn. Pet. 8; Nat. Fuel Pet. 16.

[28] Pet. App. 33a-34a.

additional gas supplies at high prices and subject to high take-or-pay requirements," Order No. 500-H, FERC Stats. & Regs. at 31,509, or (ii) failed to meet any of their own contractual obligations. Tennessee acted on the basis of its own projections of customer needs and market trends, *see* Pet. App. 58a-59a, primarily in order "to assure a source of supply for gas" for customers it had agreed to serve—many of which were at the time without alternative sources of gas. Comm. Pet. 22.

By Tennessee's own estimate, only one-third of its costs are for buying out accumulated exposure for unpaid take-or-pay claims, *see* p. 3, *supra*, and, even as to this one-third, the surcharged customers cannot be said to have "caused" the costs except in the sense that anyone's failure to purchase anything "causes" the vendor thereof to have a larger inventory than he otherwise would.[29] To the extent that Tennessee's take-or-pay liability accumulated in the period 1983-86, it would obviously have been lower if no 1981-82 customer had reduced its purchases in 1983-86.[30] But a customer whose own needs declined, because of conservation by residential customers or for other reasons, or which, with FERC's encouragement, sought lower priced supplies elsewhere, did not "cause" Tennessee's oversupply any more than a customer who delays replacing his aging Chevrolet "causes" General Motors' "resulting" inventory surplus.

In any event, Tennessee alleged and, in 1988, FERC agreed that two-thirds of Tennessee's estimated costs were for prospectively reforming its gas supply contracts

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[29] As a factual matter, it is equally true that customers who failed to *increase* their purchases in 1983-86 likewise "caused" Tennessee's oversupply.

[30] It would also have been lower if Tennessee had *made* the take-or-pay prepayments, in which event, under standard FERC practice, the costs would (if prudently incurred) have been added to Tennessee's rate base and recovered through future rates rather than a retroactive surcharge. *See* Pet. App. 71a, 108a-109a.

to reduce or eliminate the continuing gap between the prices Tennessee had contracted to pay and the projected market price of gas. As to that two-thirds, the statement that customers whose purchases declined in 1983-86 were the "cause" makes no sense whatever: customer purchase decisions in 1983-86 did not cause the gap between Tennessee's purchase contract prices and market prices; the reformation costs were incurred to make Tennessee's gas marketable, and they serve to reduce the prices at which Tennessee can sell gas in the future—benefiting current and future customers, not past ones.

Even if the "cost causation" theory had a sound factual basis, there simply is no rule that permits the Commission to adjust filed rates retrospectively so that costs will be borne by customers the Commission judges, in hindsight, to have had some role in "causing" them.[31] To the contrary, pipelines and their customers are private entities that enter into contracts based on perceptions of their current and future needs. The Commission's role, as this Court has said many times, is to ensure that the terms of those contracts are just and reasonable, not to "award reparations on the ground that a properly filed rate or charge has in fact been unreasonably high or low." *Montana-Dakota Utils. Co. v. North-*

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[31] Petitioners' citations in support of their cost-causation theory are misplaced: the cases concern only the design of prospective rates, in which costs of service are one of several factors considered in setting just and reasonable rates. For example, in *Public Sys. v. FERC*, 709 F.2d 73 (D.C. Cir. 1983), cited in Comm. Pet. 23, the court of appeals held that in setting rates costs should be allocated in such a manner that "the customers who pay the expense receive the tax benefit associated with that expense." *Alabama Elec. Coop., Inc. v. FERC*, 684 F.2d 20 (D.C. Cir. 1982), and *Cities of Riverside & Colton v. FERC*, 765 F.2d 1434 (9th Cir. 1985), involved the principle that, to avoid discrimination, rates should be set so that revenues from each class of customer match as closely as possible the costs of "providing service" to that class. *Alabama Elec.*, 684 F.2d at 27. None of these cases suggests that reparations or surcharges for past periods are permissible.

western Pub. Serv. Co., 341 U.S. at 258 (Frankfurter, J., dissenting).

(e) Petitioners' argument is not helped by their invocation of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). *Chevron* requires no deference to agency assertions of authority that are contrary to the authoritative construction of a statute by this Court. *Id.* at 843 n.9; *accord, Board of Governors of Federal Reserve Sys. v. Dimension Fin. Corp.*, 474 U.S. 361, 368 (1986); *INS v. Cardoza-Fonseca*, 480 U.S. 421, 466-68 (1987).[32] In *Maislin*, this Court's most recent examination of the filed rate doctrine, the Court used words strikingly applicable here: "Once we have determined a statute's clear meaning, we adhere to that determination under the doctrine of *stare decisis*, and we judge an agency's later interpretation of the statute against our prior determination of the statute's meaning." 110 S. Ct. at 2768.

(f) Equally misplaced is petitioners' reliance on the "end result" test of *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). *Hope Natural Gas* was concerned with judicial review of rates set by an agency that has properly exercised its statutory authority; nothing in that case suggests that "reasonableness" displaces all statutory requirements. To the contrary, numerous decisions make clear that the first duty of a reviewing court is to ensure that the agency has not "abused or exceeded its authority." *E.g., In re Permian Basin Area Rate Cases*, 390 U.S. 747, 791-92 (1968). If the agency has exceeded its authority, its actions cannot be saved by the alleged reasonableness of the end result. *See, e.g., United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332

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[32] The Court has recently reaffirmed the respect "this Court must accord to long-standing and well-entrenched decisions, especially those interpreting statutes that underlie complex regulatory regimes." *California v. FERC*, No. 89-333, 110 S. Ct. 2024, 2029 (1990).

(1956); *Public Serv. Comm'n v. Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983).

(g) This case is not at all like *Mobil Oil Exploration & Producing Southeast, Inc. v. FERC*, 885 F.2d 209 (5th Cir. 1989), *cert. granted, Mobil Oil Exploration & Producing Southeast, Inc. v. United Distrib. Cos.*, No. 89-1452, 110 S. Ct. 2585 (1990), cited "passim" by Tennessee. In that case, the Solicitor General represented to this Court that the Fifth Circuit's decision would call into question some 1600 producer-pipeline contracts, possibly unravel settlements of numerous take-or-pay disputes, lead to widespread state-court litigation, and recreate serious distortions in the natural gas market, increasing dependence on foreign oil and gas.[33] Nothing of the sort is shown here: the decision below will result at most in the administrative cost and inconvenience of revising an unlawful scheme of charges to pipeline customers.[34]

3. Petitioners also attempt to suggest that a retroactive "deficiency" charge is the only equitable solution to Tennessee's problem. Although the dispositive answer to this argument is that the charge is not a *lawful* solution, we note briefly that it is not equitable either, and that it is by no means the only solution.

The "deficiency" charge severely punishes those Tennessee customers that, in the particular period 1983-86, reduced purchases because *their* customers were conserving energy, or because they or their customers responded to the encouragement of the Commission or state regulators to "pursue least-cost [gas purchase] strategies." Order No. 380, FERC Stats. & Regs. at 30,964. First,

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[33] Response for the Federal Energy Regulatory Commission Supporting Application for Stay, No. A-503, at 19.

[34] The Commission has recently recognized that revising the method of spreading take-or-pay and contract reformation costs among pipeline customers does not affect the Commission's basic "equitable sharing" policy. *Northern Natural Gas Co.*, 52 FERC ¶ 61,044 at 61,203 (1990).

the deficiency charge resulting from each Mcf of gas not purchased will almost surely far exceed the cost savings from buying an Mcf from another supplier.[35] Second, as previously noted, two-thirds of the costs that would be borne by customers whose purchases declined in 1983-86 are estimated by Tennessee and FERC to be for prospective contract reformation and have nothing to do with the amount of gas Tennessee sold in 1983-86. Third, these customers, including pipelines, other utilities, and end users, obviously could not timely reflect the retroactive surcharge in their own purchase decisions and rate filings for the 1981-86 period.[36]

Nor is a retroactive purchase deficiency charge the only way to solve the take-or-pay problem. The traditional way of recovering the cost of gas supplies (if prudently incurred) is to include them in current commodity

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[35] Tennessee has computed customers' deficiency allocation factors based on approximately 383 million Mcf in total average annual deficiencies during the 1983-86 period. *See* Tennessee tariff filing March 31, 1989, and Schedule 5a of supporting workpapers, approved in part by the Commission, *Tennessee Gas Pipeline Co.*, 47 FERC ¶ 61,137 (1989). If Tennessee were ultimately to bill up to its cap of $650 million under this method, customers would be now charged approximately 42 cents for each Mcf of gas not taken from Tennessee during the four-year deficiency period. This is substantially larger than the price differential normally sufficient to induce a customer to pursue lower cost alternatives.

[36] The court of appeals properly rejected the contention that language in Order No. 380 addressing possible future changes concerning recovery of carrying charges on take-or-pay prepayments somehow notified a pipeline's customers to expect a surcharge:

> Order No. 380 post-dated the entire base period and half of the deficiency period. The Commission can perhaps assume that petitioners have some acquaintance with regulatory changes in the natural gas industry, but it cannot require them to be clairvoyant. Upon consideration of the text of Order No. 380, we conclude that FERC's indication that carrying charges on prepayments 'may require special consideration' is delphic at best . . . .

Pet. App. 14a.

rates. The Commission endorsed that approach to take-or-pay contract buyout and reformation costs in its 1985 Policy Statement, *see* p. 8, *supra*, and the Commission's current regulation, 18 C.F.R. § 2.104(a), provides that "pursuant to existing Commission policy and practice . . . pipelines may pass through prudently incurred take-or-pay buyout and buydown costs in their sales commodity rates."

Another alternative would be a direct charge allocated in accordance with current contract entitlements. As described above, *see* p. 10, *supra*, Tennessee proposed and the Commission initially approved that method for recovering some of the take-or-pay buyout costs and all of the contract reformation costs (estimated to be two-thirds or more of the total) and the Commission's later change of mind on that proposal was virtually unexplained.[37] Still another method conceded by the Commission to be "potentially available," Comm. Pet. 28, is a "volumetric" surcharge on future rates for both sales and transportation of gas; "open access" pipelines are already allowed by Order No. 500 to use this method to recover up to 50 percent of their buyout and reformation costs, and FERC itself has endorsed and defended the method in a number of recent decisions.[38]

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[37] The D.C. Circuit has found that this method of recovering deferred gas costs would not violate the filed rate doctrine or be otherwise unlawful as to amounts accruing prospectively from the issuance of the Commission's order approving such method. *Transwestern Pipeline Co. v. FERC*, 897 F.2d 570, 579 (D.C. Cir. 1990).

[38] *E.g.*, *Transcontinental Gas Pipe Line Corp.*, 51 FERC ¶ 61,297 at 61,955 (1990); *CNG Transmission Corp.*, 51 FERC ¶ 61,158 at 61,433 (1990); *Northern Natural Gas Co.*, 51 FERC ¶ 61,157 at 61,431-32 (1990) (approving settlement using only volumetric surcharge and no direct billing). In these cases, the Commission justifies the prospective allocation of a portion of the take-or-pay costs to transportation customers not because these customers "caused" the pipeline's take-or-pay problem, but because they are benefiting from the transition of the pipeline to open-access status.

The choice among the lawful approaches to the recovery of these costs should be made in the first instance by the Commission, and the court of appeals properly returned the case to the Commission to choose among the alternatives that are permitted by the statute. As this Court said of the Interstate Commerce Commission in *Maislin*: "Although the Commission has both the authority and expertise generally to adopt new policies when faced with new developments in the industry, . . . it does not have the power to adopt a policy that directly conflicts with its governing statute." 110 S. Ct. at 2770.

CONCLUSION

For the reasons stated above, the petitions for writ of certiorari should be denied.

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August 31, 1990

APPENDIX

APPENDIX

APPENDIX

TENNESSEE GAS PIPELINE
DIVISION OF TENNECO INC.

Tenneco Building
P.O. Box 2511
Houston, Texas 77001
(713) 757-2131

April 29, 1983

To The Producer/Supplier Addressed In
The Transmittal Letter To Which
This Notice Letter Is Attached:

The purpose of this letter is to give formal notice to the producers/suppliers of Tennessee Gas Pipeline Company (Tennessee) of the emergency gas purchase policy which Tennessee will implement with respect to the purchase of natural gas under its contracts for gas supplies, commencing May 1, 1983. On April 29, 1983, at the Hyatt Regency Hotel in Houston, Texas, Tennessee presented a program for its producers/suppliers which described in detail the current and projected conditions in Tennessee's natural gas markets which necessitated the implementation of the emergency gas purchase policy, and which indicated the objectives which Tennessee believes will be accomplished by its implementation.

Tennessee is, and since late 1982 has been, confronted with an increasingly severe imbalance between the gas supplies deliverable to it under gas contracts with its producers/suppliers, and the ability of its markets to absorb natural gas at Tennessee's current price levels. Tennessee's gas markets have been progressively eroded by a combination of events and circumstances, including: an unexpected economic recession of unanticipated length and severity; the perverse effect of the pricing scheme of the Natural Gas Policy Act of 1978 (NGPA) on the pricing provisions in the majority of post NGPA contracts for

the wellhead purchase of natural gas, which were made in an environment of intense competition for gas supplies following a prolonged period of gas shortage and curtailment; a worldwide glut of crude oil resulting in a precipitous drop in the price of competing fuels; and an extremely mild 1982-1983 winter heating season in Tennessee's market areas. None of these events are matters over which Tennessee has any control, nor were they foreseen or foreseeable when the contracts between Tennessee and its producers/suppliers were entered into.

There is an immediate danger that unless Tennessee is able to substantially reduce the cost of its natural gas delivered to its customers, an even larger portion of Tennessee's market for natural gas will be lost, and that the market losses Tennessee has already sustained and will sustain will be permanent. In order to prevent further irretrievable market loss, and to commence to remedy the adverse market conditions now existing, Tennessee must act now to reduce the weighted average cost of its purchased gas and, in turn, the price of gas to its customers. Therefore, Tennessee will, beginning May 1, 1983, implement the emergency gas purchase policy set out below. Tennessee hereby gives notice that due to the unforeseen and severely adverse conditions described above which are expected to exist throughout 1983, 1984 and 1985, the provisions of any of its gas purchase contracts which are contrary to the emergency gas purchase policy set out below must be and therefore are suspended.

Tennessee's emergency gas purchase policy, which will be in force from May 1, 1983, consists of the following:

1. *Reduced Purchase Obligations*:

(a) For purposes of measuring volumes of gas which Tennessee is obligated to take or nonetheless pay for, such obligations shall be deemed to be the following:

(i) As to NGPA Section 108 gas and all casinghead gas, 100% of the minimum contract quantity provided for under the applicable contract;

(ii) As to NGPA Section 104, Section 105, Section 106 and Section 109 gas, and as to each vintage or subcategory of such gas, the lesser of 70% of Seller's Delivery Capacity of each category, vintage or subcategory of such gas, or the minimum contract quantity provided for under the applicable contract;

(iii) As to NGPA Section 102, Section 103 and Section 107 gas, including tight sands gas, deep gas and other incentive priced gas, the lesser of 50% of Seller's Delivery Capacity of each category of gas or the minimum contract quantity provided for under the applicable contract.

(b) For purposes hereof, "Seller's Delivery Capacity" shall mean Seller's delivery capacity as defined in each applicable contract, and shall be no greater than the determination as to such capacity last made and agreed to under the terms and procedures of such contract and in effect on the day before the effective date of Tennessee's emergency gas purchase policy, unless Tennessee thereafter agrees in writing with any producer on a higher level of Delivery Capacity and/or reserves. Seller's Delivery Capacity will be determined by NGPA pricing category and subcategory, and by vintage within each NGPA pricing category or subcategory where applicable.

(c) Tennessee will nominate from time to time the daily level of gas volumes it will take from each producer under each contract from each respective NGPA pricing category and subcategory, up to 100% of Seller's Delivery Capacity from each such category.

Initially, insofar as reasonably practicable, Tennessee intends to determine its level of nominations from each respective NGPA pricing category and subcategory by multiplying the percentage of Seller's Delivery Capacity specified below by a fraction, the numerator of which is the sum of Tennessee's nominations from all of its producers/suppliers and the denominator of which is the sum of the percentage levels prescribed below for all NGPA pricing categories and subcategories. The percentage levels of Seller's Delivery Capacity to be used in establishing Tennessee's nominations are:

(i) 100% of the minimum contract quantity provided for under the applicable contract for all NGPA Section 108 gas and casinghead gas;

(ii) 70% of Seller's Delivery Capacity for NGPA Section 104, Section 105, Section 106 and Section 109 gas, and for each vintage or subcategory of such gas; and

(iii) The lesser of the minimum contract quantity provided for under the applicable contract or 50% of Seller's Delivery Capacity for NGPA Section 102, Section 103 and Section 107 gas, including tight sands gas, deep gas and other incentive priced gas.

However, in no event will Tennessee nominate take levels for any NGPA Section 107 gas included within subparagraph (iii) above which is not subject to a currently exercisable market out, economic out or similar contractual clause in excess of 50% of Seller's Delievery Capacity of gas in such category unless Tennessee has previously made take or pay payments with respect to such gas which have not been made up. Tennessee will take ratably from all producers by NGPA pricing category, subcategory and vintage. The manner in which Tennessee intends initially to

nominate takes under this emergency gas purchase policy is illustrated by Appendix A.

(d) Paragraph 3 (c) notwithstanding, Tennessee intends to nominate take levels for various NGPA pricing categories of gas in such manner as to receive as quickly as possible make up gas attributable to take or pay payments made by Tennessee prior to the effective date of its emergency gas purchase policy. To meet these objectives, the level of takes nominated by Tennessee from time to time from any NGPA pricing category, subcategory or vintage, will be likely to differ from the level of takes nominated from any other NGPA pricing category, subcategory or vintage.

(e) Tennessee will notify its producers of its nominations of take levels as far in advance of the effective date of such nominations as practical. Pending receipt of notice from Tennessee of its initial level of nominations under the emergency gas purchase policy, each producer/supplier should maintain deliveries at the current volume level requested by Tennessee; however, each producer/supplier should immediately adjust its delivery mix among NGPA pricing categories so as to be in accord with the percentages set forth in paragraph 1 (a).

2. *Gas Pricing*:

(a) Concurrently herewith, Tennessee is providing separate notice to all producers whose contracts contain currently exercisable market out, economic out or similar clauses, that at the earliest date provided for and pursuant to the applicable clause, Tennessee will pay for volumes of gas taken under those contracts the lesser of the applicable NGPA maximum lawful price or $3.40 per MMBtu inclusive of all severance taxes, gathering charges and other similar fees and charges.

(b) With respect to gas volumes taken under contracts which contain no currently exercisable market out, economic out or similar clause, effective May 1, 1983 Tennessee will pay no more than the applicable maximum lawful price or, if no maximum lawful price is applicable, 110% of the No. 2 fuel oil index as published monthly by the Federal Energy Regulatory Commission (FERC) pursuant to Section 203 of the NGPA inclusive of all severance taxes, gathering charges and similar fees and charges.

(c) Since Tennessee will be nominating the volumes of gas which it will take by NGPA pricing category, subcategory and vintage, Tennessee will tender payment for deliveries of gas to it, and recognize take or pay claims, based on volumes and prices calculated as if producers had delivered gas as nominated by Tennessee; deliveries of gas by any producer in excess of the total volumes nominated by Tennessee will be treated as excess gas in accordance with Tennessee's excess gas policy set out in its letter to producers dated March 23, 1983, a copy of which is attached hereto as Appendix B. In no event will Tennessee make payments for gas delivered, or recognize a take or pay obligation, based upon any price which exceeds the maximum lawful price applicable to the NGPA pricing category of gas actually delivered by a producer.

3. *Take or Pay Payments*:

(a) Tennessee will recognize, pursuant to the terms of applicable contracts, claims for sums validly due and owing under take or pay provisions of such contracts by producers who agree in writing to the amendment of such contracts consistent with Tennessee's emergency gas purchase policy; regardless of whether such claim arises out of contract years ending on, before or after the effective date of Tennes-

see's emergency gas purchase policy, Tennessee will not recognize any invoice for sums claimed under take or pay provisions of any contract which has not been so amended, and unless the producer/supplier provides assurance of either delivery of make-up of volumes of gas paid for but not taken, or refund of payments therefor, satisfactory to Tennessee.

(b) Subject to the provisions of subparagraph 3 (a), beginning January 1, 1983, Tennessee's recognition of an obligation to pay for volumes of gas not taken below minimum contract quantity shall be limited to the levels specified in paragraph 1 (a). Gas volume levels by which Tennessee's take or pay obligations are measured shall be as specified in the applicable contract for periods prior to January 1, 1983, and as specified in paragraph 1 from and after January 1, 1983 through the term of the emergency gas purchase policy, and thereafter as specified in the applicable contract.

(c) Tennessee shall have the right to take volumes of gas as make up for volumes paid for but not taken pursuant to Tennessee's recognized take or pay obligations under the applicable contract, as amended by Tennessee's emergency gas purchase policy, at any time during the primary term of the applicable contract; provided, however, that no volumes taken by Tennessee may be received as make up during any contract year until the then applicable minimum annual quantity for such contract year has been taken by Tennessee, and that in making up deficiencies in takes, deficiencies shall be deemed to be made up in the chronological order in which they occurred. If at the end of the primary term of the applicable contract, or if due to the depletion of the reserves of gas covered by the applicable contract or the occurrence of an event of force majeure which precludes the ability of the producer to deliver to Tennessee or for Ten-

nessee to receive make up volumes, Tennessee has not made up all deficiency volumes paid for but not taken under the provisions of the applicable contract, as amended by Tennessee's emergency gas purchase policy, the producer shall, within sixty (60) days of Tennessee's request, refund to Tennessee all payments previously made by Tennessee to the producer for the deficiency volumes which Tennessee has not made up.

4. *Release of Gas Reserves*:

(a) Tennessee will take no volumes of NGPA Section 107 gas, either tight sands gas, deep gas or other incentive-priced gas, under contracts which contain no currently exercisable market out, economic out or similar clause, unless by May 26, 1983, the producer has agreed to amend the applicable contract consistent with Tennessee's emergency gas purchase policy. In the event such agreement is not received in Tennesse's Houston office by that date, Tennessee will cease taking such gas and deliver to the producer a release of all affected gas reserves from the provisions of the applicable contract, effective that date.

(b) Tennessee will, upon receipt prior to the earlier of the date on which the applicable market out, economic out or similar clause becomes exercisable by Tennessee or the termination of the emergency gas purchase policy, of a written request from a producer of NGPA Section 107 deep gas, tight sands gas or other Section 107 incentive priced gas, covered by a contract which contains no currently exercisable market out, economic out or similar clause and as to which the producer has agreed to an amendment consistent with Tennessee's emergency gas purchase policy, release such gas reserves from the provisions of the applicable contract.

(c) Upon the written request of any producer, Tennessee will consider the release of any non-NGPA

Section 107 gas reserves which are not committed or dedicated to interstate commerce under the terms and provisions of the Natural Gas Act, to the extent that the reduction in takes of gas from such reserves by Tennessee pursuant to its emergency gas purchase policy will demonstrably result in substantial and irreparable drainage of such producer's reserves by another producer, subject to Tennessee's reserved right to retain such gas reserves by agreeing to increase its purchases of such gas to a level which will avoid such drainage.

(d) The provisions of paragraphs 4 (a), (b) and (c) to the contrary notwithstanding, Tennessee will not release any gas or gas reserves under any contract with respect to which Tennessee has paid the producer for gas not taken, unless in its request for release of such gas or gas reserves the producer agrees to refund such prepayment to Tennessee.

(e) Tennessee will, to the extent of any available capacity in its pipeline system, transport released gas volumes on behalf of a producer/supplier to a mutually agreeable point or points, on an interruptible basis.

5. *Term*:

(a) Tennessee's emergency gas purchase policy shall be in effect from and after 12:01 a.m. Central Daylight Time on May 1, 1983, until 12:00 p.m. Central Standard Time on December 31, 1985.

(b) Should the events and circumstances which have necessitated the implementation of Tennessee's emergency gas purchase policy cease to exist, in Tennessee's judgment, prior to December 31, 1985, Tennessee shall promptly give written notice of the time and date of such cessation, and the time and date on which its emergency gas purchase policy shall no longer be in effect.

(c) Upon the termination of Tennessee's emergency gas purchase policies and procedures, the make up rights specified in paragraph 3 (c) shall continue to be applicable so long as gas purchase and sales operations are conducted between Tennessee and its producers pursuant to any contract affected by Tennessee's emergency gas purchase policy.

You may indicate your agreement to the amendment of the gas purchase and sales contract between you and Tennessee referenced on the transmittal letter to which this notice letter is attached, consistent with the terms and provisions of Tennessee's emergency gas purchase policy as set out in this letter, by filling out and signing the enclosed copy of the signature page of this letter in the space provided below and returning it to Tennessee. Should you prefer to so amend your gas purchase and sales contract with Tennessee in a more formal manner, Tennessee will provide a formal amendment document to you upon request.

Tennessee sincerely believes that implementation of its emergency gas purchase policy is the only course available in the light of, and during the continuation of, the current circumstances, and that the implementation of its emergency gas purchase policy will serve both to stop the loss of markets which Tennessee is now experiencing, and to increase Tennessee's sales levels. Tennessee submits that this result is in your best interest, and urgently solicits your agreement, cooperation and assistance. Tennessee's implementation of its emergency gas purchase policy is not, however, dependent upon the agreement of its producers/suppliers, and will commence in all events on May 1, 1983.

Questions concerning Tennessee's emergency gas purchase policy should be directed to Mr. T. M. Matthews, Vice President, Tennessee Gas Transmission Company,

P. O. Box 2511, Houston, Texas 77001, Telephone (713) 757-3871.

Very truly yours,

TENNESSEE GAS PIPELINE
COMPANY,
A DIVISION OF TENNECO INC.

By /s/ T. M. Matthews
T. M. MATTHEWS
Agent and Attorney-in-Fact

Nos. 89-1988, *et al.* and 89-2001, *et al.*

Supreme Court, U.S.
FILED
AUG 31 1990
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

THE BERKSHIRE GAS CO., *et al.*,
Petitioners,

v.

ASSOCIATED GAS DISTRIBUTORS,
Respondent.

PANHANDLE EASTERN PIPE LINE CO., *et al.*,
Petitioners,

v.

COLUMBIA GAS TRANSMISSION CORP.,
Respondent.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF RESPONDENTS THE PROCESS GAS CONSUMERS GROUP, THE AMERICAN IRON AND STEEL INSTITUTE, AND THE GEORGIA INDUSTRIAL GROUP IN OPPOSITION

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---

BRIEF OF RESPONDENTS THE PROCESS GAS CONSUMERS GROUP, THE AMERICAN IRON AND STEEL INSTITUTE, AND THE GEORGIA INDUSTRIAL GROUP IN OPPOSITION

STATEMENT

Respondents the Process Gas Consumers Group, the American Iron and Steel Institute, and the Georgia Industrial Group respectfully request that this Court deny the Petitions for Writs of Certiorari sought herein to review the judgments and opinions of the United States

Court of Appeals for the District of Columbia Circuit in *Associated Gas Distributors v. FERC*, 893 F.2d 349 (D.C. Cir. 1989), *reh'g denied en banc*, 898 F.2d 809 (1990) ("AGD"), and *Columbia Gas Transmission Corp. v. FERC*, 895 F.2d 791 (D.C. Cir. 1989) ("*Columbia*").

Both cases involve the use of direct billing mechanisms keyed to customers' past purchases of natural gas. The court of appeals correctly found that these mechanisms violate the statutory prohibitions known collectively as the filed rate doctrine and the rule against retroactive ratemaking.

We join in the August 31, 1990 Briefs of Respondents in Opposition in both cases and, for the sake of brevity, adopt the Questions Presented and the Statements contained therein.

REASONS FOR DENYING THE WRIT

During the past few years, this Court has seen a spate of certiorari petitions arising out of decisions involving the Federal Energy Regulatory Commission's ("FERC") regulation of the natural gas industry. Due to the extraordinary diversity of interests among the myriad parties interested in natural gas matters (and the large amounts of money typically involved), it is perhaps not surprising that frequently, in cases having industrywide effect, *some*one (including FERC itself) will feel strongly enough about an issue to seek review by this Court. Yet, as passionate as a petitioner in any such case may feel about "its issue," few such issues actually rise to certiorari standards.

High passions notwithstanding, the instant FERC cases too fail to warrant certiorari. In fact, they present two examples of a classic, but entirely ordinary, administrative situation: an agency **earnestly** wished to achieve certain policy goals, but it sought to do so through means clearly outside its statutory authority. On review, the court of appeals twice applied well-settled law that, no matter how

well-intentioned the agency's objectives might be, it lacked authority to increase rates *after the fact* for gas already sold. To do so, the D.C. Circuit held, was in clear violation of Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. §§ 717c, 717d (1988) (the "Act"). Thus rejecting FERC's verbal somersaults purporting to show the prospective allocation of the gas costs involved, the court of appeals correctly concluded that FERC's orders in fact *raise rates for past purchases and do not merely use historic purchase data as a basis for setting prospective rates.*

The decisions below are neither novel nor expansive (*contra* FERC 89-1988 Pet. at 27); rather, they are supported by numerous decisions of this Court applying the filed rate doctrine and its companion rule against retroactive ratemaking. Allowing the D.C. Circuit's decisions to stand will not have the dire consequences FERC and other Petitioners suggest; rather as in most cases, alternative administrative remedies—that *are within* FERC's legal authority—*do* exist and may be pursued on remand.

Finally, the petitions' extended discussion and repeated emphasis of the policy rationale underlying FERC's orders seem to reflect the same common regulatory error recognized by the D.C. Circuit: the agency confuses (a) that which it believes it *should* do as a matter of policy with (b) that which it actually *can* do as a matter of law. Where the former conflicts with the latter, the latter must control; it is up to the Congress—not the agency nor the courts—to remedy the matter. *See generally Maislin Industries U.S. v. Primary Steel, Inc.*, 495 U.S. ——, 110 S.Ct. 2579, 2770 (1990).

Accordingly, the decisions below do not warrant the exercise of certiorari jurisdiction.

I. THE D.C. CIRCUIT CORRECTLY APPLIED WELL SETTLED STATUTORY AND DECISIONAL LAW THAT PUBLIC RATE PREDICTABILITY LIES AT THE HEART OF THE NATURAL GAS ACT'S CONSUMER PROTECTION PURPOSES.

This Court has long recognized that the Natural Gas Act was designed to "protect the consumer interests against exploitation at the hands of private natural gas companies," *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 612 (1944), affording "a complete, permanent and effective bond of protection from excessive rates and charges." *Atlantic Refining Co. v. Public Service Comm'n of New York*, 360 U.S. 378, 388 (1959). It is likewise well settled both that a regulated natural gas company's charges for jurisdictional service are governed solely by its filed rates and that "the Commission itself has no power to alter a rate retroactively." *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578 (1981); *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. 145, 152-153 (1962); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956). The decisions below are wholly consistent with both this Court's interpretation of the Act generally and its rulings on the filed rate doctrine specifically.

There is nothing "novel and expansive" (FERC 89-1988 Pet. at 27) about the D.C. Circuit's view that the filed rate doctrine is intended to protect consumers by insuring rate predictability.[1] Indeed, the filed rate doctrine is the direct product of Sections 4(c) and 4(d) of the

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[1] Despite its claims here, FERC has itself properly observed elsewhere that one of the "policy bases" of the filed rate doctrine is "the need for certainty as to the rates and other terms governing a regulated transaction." *Arkansas Louisiana Gas Co. v. Hall*, 13 FERC ¶ 61,100 at 61,212 (1980), *rev'd sub nom. Hall v. FERC*, 691 F.2d 1184 (5th Cir. 1982) (reversed for abuse of discretion in denying waiver of notice under Section 4(d) of the Act to give effect to contractually authorized rates), *cert. denied*, 464 U.S. 822 (1983).

Act, *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. at 576-77, and rate predictability for the public lies at the heart of those provisions. Section 4(c) requires "public" posting of all rates and charges for any service subject to FERC's jurisdiction. 15 U.S.C. § 717c(c). Section 4(d) requires 30 days' notice to FERC "and to the public" of any rate changes and requires companies to state "plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect." 15 U.S.C. § 717c(d). Advance public notice of changes in filed rates is both pointless and worthless unless consumers can rely on those published rates and make their purchasing decisions accordingly.

In the face of these consumer protection purposes, FERC suggests implausibly that Section 4 is instead intended to serve primarily the purpose of making **the agency itself** aware of rate increases and preserving its primary jurisdiction. It does not, however, require plenary Supreme Court review to confirm that FERC's suggestion ignores both the express language of the Act and the consumer interests it was "plainly designed" to protect. *FPC v. Hope Natural Gas Co.*, 320 U.S. at 612.

Congress quite deliberately balanced the interests of consumers and regulated pipelines in Sections 4 and 5 of the Act. Section 4 protects consumers from retroactive increases in filed rates; at the same time, Section 5 protects pipelines from having to make retroactive refunds when previously approved rates are found to be no longer just and reasonable. The decisions below correctly maintain this balance and reject FERC's strained view of Section 4, which would have allowed pipelines to increase their rates retroactively for gas their customers have *already* bought. *See AGD*, 898 F.2d at 810 (Williams, J. concurring).

Predictability of filed rates is an essential component of the Act's consumer protection objectives. As in any consumer decision, consumers' gas purchase decisions are

based in part on the rate they face, *i.e.*, how much their utility bill will be. This is especially so for price-sensitive industrial and large commercial consumers, who typically make their energy purchase decisions based on the cost of a *variety* of competing sources, including gas from numerous non-utility suppliers, oil, propane, and other fuels. Price differentials of as little as a penny influence these consumers' choices among potential suppliers.[2] If a consumer cannot rely on the continued effectiveness of the currently filed rates—*i.e.*, if he is exposed to *post hoc* increases in the rates charged for gas he has *already* purchased—then rational purchasing and business planning become impossible. Pipelines' filed rates not only determine the consumer's choice of suppliers and transportation routes, but also affect both (1) the prices offered by other energy sellers and (2) the discounts offered by competing gas pipelines and local utilities trying to market their sales and transportation services. Though FERC seems to scoff at the need for rate certainty with respect to gas already purchased (*e.g.*, FERC 89-1988 Pet. at 24), such certainty is fundamental to rational economic decisionmaking. By opening the Pandora's box of retroactive ratemaking here, FERC has encouraged rate gamesmanship among pipelines and has substituted commercial chaos for the rate predictability inherent in the Act's public tariff filing requirements.

The Acting Solicitor General's assertion that it is "unrealistic" to assume that clear purchasing choices always exist (FERC 89-1988 Pet. at 24) is belied by FERC's own clear policy specifically to maximize and encourage such choices. Indeed, in its Order 436, FERC termed open access transportation—which allows consumers the freedom to choose their suppliers and make their own purchasing decisions—the "cornerstone" of its

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[2] Similarly, pipelines' wholesale customers—typically local gas utilities—make monthly (and sometimes daily) decisions about their own purchases, since gas is often available from a number of different suppliers at varying prices.

program.[3] To provide consumers with clear purchasing choices is one of FERC's acknowledged policy objectives.[4] For the agency now to allow counsel to suggest to this Court that these objectives are "unrealistic" is to engage in self-fulfilling prophecy: that is, by seeking to erode the filed rate doctrine, FERC may well undermine its own most important policies and defeat the rate certainty so essential to market choice.

Key to the decisions below was the D.C. Circuit's recognition that, notwithstanding FERC's tortured arguments to the contrary, the rate changes approved in FERC's orders were indeed retroactive in application and effect:

> As in *Columbia Gas*, "the effect of [these orders] is quite clear: downstream purchasers [such as petitioners here] are expected to pay a surcharge, over and above the rates on file at the time of sale, *for gas they had already purchased.*"

AGD, 893 F.2d at 355-56 (emphasis added), quoting *Columbia Gas Transmission Corp. v. FERC*, 831 F.2d 1135, 1140, (D.C. Cir. 1987).

FERC's petition in *AGD* still steadfastly maintains that that it did not retroactively substitute higher rates

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[3] Order 436, FERC Statutes and Regulations [1982-1985] ¶ 30,665 at 31,494 (1985), *vacated on other grounds, Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988). *See also Associated Gas Distributors v. FERC*, 824 F.2d at 994-96.

[4] "[O]ur current policy is to encourage access between willing buyers and sellers of natural gas in an atmosphere of fair competition. The goal of this policy is to provide incentives and opportunities that allow all shippers, industrial end users as well as LDCs and other parties, to benefit by access to commodity and transportation markets . . . . The policy . . . promotes market participation by larger numbers of players, thus providing new supply options and leverage to parties seeking efficiently priced services." *Northwest Pipeline Corp.*, 52 FERC ¶ 61,053 (July 18, 1990), slip op. at 8 (footnotes omitted).

for the ones previously on file, that it merely allocated "current" costs among customers "on the basis of" the amounts of gas they did not purchase during a past period. (FERC 89-1988 Pet. at 22).[5] But, despite this semantic legerdemain, it is clear that the rates imposed in *AGD* are indeed retroactive in the common, ordinary sense that Congress no doubt envisioned. Customers who purchased gas from Tennessee Gas Pipeline Company ("Tennessee") at publicly filed tariff rates during the 1983-1986 "deficiency period" are now required to pay substantially more for *that* gas; the higher rates are decidedly *not* for the gas they currently purchase. These customers have no means whatsoever to avoid these *post hoc* charges based on any purchasing decision they can make now. As the D.C. Circuit explained, this is "virtually indistinguishable from the Commission substituting in 1988 a new rate schedule for gas purchased in 1983-1986." *See AGD*, 898 F.2d at 810 (Williams, J., concurring).

Nowhere is this more clear than in the case of customers who no longer buy any gas from the pipeline. Under the retroactive rate surcharge method approved in FERC's orders below, even pipeline customers with expired contracts are held accountable for added payments long after they have ceased purchasing any gas—and even after FERC has approved abandonment.[6]

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[5] Because the resulting rates were filed in public tariffs, FERC and its supporters argue that the agency satisfied the literal requirements of Sections 4 and 5 of the Act. Yet, in that limited sense, *any* new charge must obviously be billed and collected "prospectively"—the laws of time and physics preclude literal retroactivity.

Thus, if petitioners' argument were due any weight, it would simply eliminate all filed rate protection from the statute.

[6] *See, e.g., United Gas Pipe Line Co.*, 47 FERC ¶ 61,163 (1989); *Transcontinental Gas Pipe Line Corp.*, 46 FERC ¶ 61,343 (1989); *Trunkline Gas Co.*, 45 FERC ¶ 61,429 at 62,361-62 (1988), *appeal docketed sub nom. Michigan Consolidated Gas Co. v. FERC*, No. 88-1904 (D.C. Cir., Dec. 23, 1988). In *United*, FERC imposed the

The most dramatic examples of the real, not theoretical, retroactivity of these assessments—and the mischief that FERC could cause if its interpretation of the statute were upheld—occur on pipelines other than Tennessee that also use the purchase deficiency methodology to pass through costs to their customers.[7] For example, application of that methodology on the South Georgia Natural Gas Company system imposes costs on customers far in excess of any "current" measure of the cost of natural gas service. One such customer, the City of Andersonville, Georgia, is a town of 300 inhabitants with 83 retail gas customers. It was to be assessed $1.7 million in take-or-pay costs for gas not purchased during the "deficiency" period due to the town's loss of a major industrial gas purchaser to alternative fuels. This amounted to a staggering potential charge of over $20,000 per customer in a locality where the average annual income is less than $10,000. Based on the town's annual consumption at the time the charge was to have been imposed, the resulting surcharge would be over $480 per Mcf of gas purchased.[8] Even if FERC ultimately chooses to grant the town's long-pending request for hardship relief, it is ludicrous for the agency to pretend that these new charges are for "current" gas service.[9] They are

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added costs by taking the extraordinary step of amending an earlier order which had granted abandonment of service to the customer.

[7] The comparision to other pipelines is legitimate, since it was the purchase deficiency allocation *methodology* itself that the D.C. Circuit found to violate the filed rate doctrine, not simply Tennessee's own particular implementation of it. 893 F.2d at 362. Even FERC acknowledges the impact of the court's decision on cases involving other pipelines, as well as on its generic Order Nos. 500-H and 500-I. (FERC 89-1988 Pet. at 17-18).

[8] *See* Affidavit of Mr. Jerry Hargrove, City Clerk of the City of Andersonville, Georgia filed on July 20, 1989, in *South Georgia Natural Gas Co.*, FERC Docket No. RP88-267-008, *et al.*

[9] Abandonments and other changes in pipeline markets also illustrate how these charges are indeed retroactive in any recognizable sense. For example, two of Tennessee's customers, Colum-

clearly a *post hoc* retroactive surcharge on gas previously purchased and long since consumed.

II. FERC'S DEFICIENCY-BASED METHODOLOGY IS NOT MERELY AN EXERCISE IN COST ALLOCATION.

Also unworthy of the Court's attention is FERC's argument that the issue here is simply one of cost allocation—*i.e.*, a matter of FERC determining just and reasonable rates consistent with the "broader regulatory principle" of matching rates with responsibility for the underlying costs. (FERC 89-1988 Pet. at 23). Neither in *AGD* nor elsewhere has FERC demonstrated any relationship between a customer's **past** purchases and the costs at issue, **one-half** of which costs are attributable in Tennessee's case to relief from **future** contract obligations and take-or-pay charges. Order 500-H, FERC Statutes and Regulations III, ¶ 30,867 at 31,522 (1989), *aff'd, American Gas Association v. FERC*, —— F.2d —— (August 24, 1990). But, even if there were such a connection, the Act contains no exemption to the requirements of Sections 4 and 5. FERC is not permitted to pursue regulatory principles through means which are at war with statutory principles; it cannot lawfully attempt to match cost responsibility through retroactive rates. Stated differently, the latitude traditionally allowed FERC in cost allocation matters is not so wide as to encompass its approval of illegal rates, *i.e.*, retroactive rates which it has no authority to implement.[10]

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bia Gas Transmission Corporation and Inland Gas Company, were ordered to make payments based on contractual purchase levels formally abandoned months before the pipeline filed to recover these costs and two years before FERC issued its order approving the charges. *Tennessee Gas Pipeline Co.*, 42 FERC ¶ 61,175 at 61,634 (1988). Corning Natural Gas Corporation was assessed charges attributable to its expired contract with its pipeline, even after it had left that pipeline system. *See North Penn Gas Co.*, 48 FERC ¶ 61,196 (1989).

[10] Moreover, attaching a "cost allocation" label to this issue would not be dispositive. *See generally Arkansas Louisiana Gas*

In *Maislin Industries, U.S. v. Primary Steel, Inc.*, 495 U.S. ——, 110 S.Ct. 2759 (1990), this Court rejected a similar attempt by the Interstate Commerce Commission to override the filed rate doctrine by labelling a carrier's conduct a violation of the statutory ban against unreasonable practices. "Stripped of its semantic cover [the Commission's policy and interpretation] thus stand revealed as flatly inconsistent with the statutory scheme as a whole." Slip op. at 13. Similarly, the court of appeals here correctly rejected FERC's efforts to bootstrap its authority to set just and reasonable rates into a license to disregard the filed rate doctrine and set illegal rates.

III. FERC'S AUTHORITY IN SECTION 4 TO WAIVE NOTICE DOES NOT GIVE IT AUTHORITY TO CHANGE RATES RETROACTIVELY.

Petitioners concede the retroactive effect of the rates in *Columbia*, but they read the Act to permit pipelines nevertheless to impose such rates so long as FERC waives the statutory notice period. This reading transmogrifies Section 4's specific permission to shorten the 30-day advance notice into broad authority to increase rates for gas sold many years in the past—*i.e.*, it simply negates the filed rate doctrine. But it is impossible to conceive how Congress could have intended to give pipelines greater power to impose retroactive rates (upon a general showing of "good cause" under Section 4) than it granted FERC itself under Section 5 (to change rates only on a prospective basis and only after a specific finding that rates are unjust and unreasonable).

The Acting Solicitor General's suggestion that FERC's current view of its Section 4 waiver power dates from the late 1930s (FERC 89-2001 Pet. at 14-15 n. 10) is misleading and irrelevant. Whatever FERC's 1939

Co. v. Hall, 453 U.S. at 579, where the retroactivity of the rate increase could not be disregarded simply because it was characterized as an award of damages by the Louisiana Supreme Court.

regulation may have meant, there is no indication that FERC ever used it to impose retroactive rates without the express agreement of the parties involved. It has apparently never been tested by any court. More significantly, FERC itself has only very recently interpreted the statute to give it the authority the Acting Solicitor General now claims has long been evidenced by its regulations. In fact, as recently as 1986, in *City of Girard, Kansas v. FERC*, 790 F.2d 919, 923 (D.C. Cir. 1986), FERC argued that it had "no power" under the governing statute to order an effective date prior to the filing date of the rate change.[11]

CONCLUSION

It would be fundamentally inconsistent with the underlying purpose of regulation under the Natural Gas Act—*i.e.*, to insure that pipeline monopolies function like competitive markets to the extent feasible—to permit after-the-fact adjustment of posted prices. In no competitive market do merchants have the right to increase the price for goods sold after the customer has left the store. When a customer buys a shirt at the ticketed price, the store cannot later collect more from that customer on grounds that it discovered additional, unrecovered costs.[12]

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[11] Although *City of Girard* was decided under the Federal Power Act, that statute is "in all material respects substantially identical" to the Natural Gas Act. *FPC v. Sierra Pacific Power Co.*, 350 U.S. at 353. *See also Electrical Dist. No. 1 v. FERC*, 774 F.2d 490, 493 (D.C. Cir. 1985), in which FERC made no effort to claim that the provisions of the regulations cited here authorize it to permit rates to become effective before the date they were filed.

[12] "The wholesale purchasers . . . cannot plan their activities unless they know the cost of what they are receiving, particularly if they are retailers, who must calculate their appropriate resale rates, . . . but also if they are large-scale purchaser-users. Providing the necessary predictability is the whole purpose of the well established 'filed rate' doctrine . . . ." *Electrical Dist. No. 1 v. FERC*, 774 F.2d 490, 493 (D.C. Cir. 1985) (citations omitted).

The D.C. Circuit properly restrained FERC's abuse of its Natural Gas Act power—which is limited to setting rates only for services to be purchased subsequently. Its decisions are consistent with the language and intent of the Natural Gas Act and with this Court's prior decisions.

For the foregoing reasons, the Petitions for Writs of Certiorari should be denied.

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August 31, 1990

(4)

No. 89-2016

FILED
SEP 11 1990
JOSEPH F. SPANIOL
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1990

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

ASSOCIATED GAS DISTRIBUTORS, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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1. Respondents do not dispute our showing (Pet. 17-18, 27-30) that this case is of surpassing importance to the natural gas industry and to the Commission's effectuation of its regulatory responsibilities. The orders the court of appeals set aside, which prescribe the method by which Tennessee Gas Pipeline may allocate among its customers the costs it incurred in settling its take-or-pay liability to producers, represent a particular application of the general "equitable sharing" policy adopted by the Commission in Order Nos. 500 and 500-H.[1] That policy was instituted to resolve the take-or-pay crisis that has pervaded the natural gas industry since the early 1980s and to spread the resulting cost over the entire industry in a fair and reasonable manner. The Commission's efforts have had a dramatic impact. By the end of 1989, the equitable sharing policy enabled pipelines to reduce their current take-or-pay liabilities by $16 billion and to obtain future relief in the amount of $28 billion. Pipelines paid $8.6 billion to obtain this relief and passed

[1] FERC Stats. & Regs., Regulations Preambles ¶ 30,761 (1987); *id.* ¶ 30,867 (1989).

through $3.4 billion to their customers under the purchase-deficiency method of cost allocation at issue here. See Pet. 11.

By striking down the purchase-deficiency method—and by allowing customers whose past purchasing patterns gave rise to Tennessee's take-or-pay liability to escape responsibility for a fair portion of the settlement costs—the decision below eliminates a central component of the Commission's equitable sharing policy and undermines the overall fairness of that policy. The impact of the decision (involving $3.4 billion in take-or-pay costs) is enormous, and it affects almost all interstate pipelines and their customers. As the Commission explained in Order No. 500-H, all but two of the interstate pipelines with substantial take-or-pay liabilities utilized the purchase-deficiency method to allocate settlement costs among their customers, and the Commission has issued approximately 300 orders on more than 50 proposals by these 22 pipelines. FERC Stats. & Regs., Regulations Preambles ¶ 30,867, at 31,522 & nn.77, 78 (1989). More than 50 petitions for review of such Commission orders are being held in abeyance by the court below pending disposition of this case.

If the decision below is permitted to stand, much of the pass-through that has already been accomplished under these numerous Commission orders will have to be undone. As a result, a final resolution of the take-or-pay problem, and the transition to the competitive market mandated by Congress, will be disrupted and delayed while the Commission conducts still further proceedings in an attempt to devise and implement some other means of allocating take-or-pay costs equitably among pipeline customers. The D.C. Circuit acknowledged in its recent decision in *American Gas Ass'n* v. *FERC*, No. 87-1588 (Aug. 24, 1990), that the ruling below would require the Commission "to unscramble the equitable sharing egg," and it accordingly declined to order the Commission to cease utilizing the purchase-deficiency method while the instant case is before this Court. Slip op. 45.

American Gas Ass'n sustained those features of Order No. 500-H that were designed to resolve the take-or-pay problem as between producers and pipelines. Slip op. 25-32. The decision below involves the remaining piece of the puzzle: resolution of the take-or-pay problem as between pipelines and their customers. If the Court grants review and sustains the Commission on that piece as well, it will enable the Commission and the natural gas industry, at last, to put the bedeviling take-or-pay crisis behind them.

Moreover, respondents do not deny that the impact of the D.C. Circuit's novel and expansive view of the filed rate doctrine extends well beyond the take-or-pay context; that court has followed the same approach in invalidating other orders that were similarly designed to allocate costs in a just and reasonable manner. See *Columbia Gas Transmission Corp.* v. *FERC*, 895 F.2d 791, 793-795 (D.C. Cir. 1990), and *Transwestern Pipeline Co.* v. *FERC*, 897 F.2d 570, 576-581 (D.C. Cir. 1990). The Commission has filed certiorari petitions in both those cases, suggesting that the petitions be held and disposed of in light of the Court's disposition of the instant case (*FERC* v. *Columbia Gas Transmission Corp.*, No. 90-131 (filed July 18, 1990), and *FERC* v. *Public Utilities Comm'n of California*, No. 90-367 (filed Aug. 29, 1990)), and the affected pipelines have filed certiorari petitions seeking plenary review (*Panhandle Eastern Pipe Line Co.* v. *Columbia Gas Transmission Corp.*, No. 89-2001 (filed June 22, 1990), and *Transwestern Pipeline Co.* v. *Kansas Power & Light Co.*, No. 90-344 (filed Aug. 24, 1990). Review by the Court in this case can serve to resolve these other cases as well and to forestall a further compounding of the D.C. Circuit's error in future cases.

2. On the merits, we have demonstrated (Pet. 18-27) that the court of appeals' invalidation of the Commission's orders was based not on the terms of the statutory provisions under which they were issued, but rather on a view of the filed rate doctrine as essentially a judi-

cially fashioned rule that can be expanded by the courts in a common-law manner according to the courts' own view of its underlying purposes. The result was to substitute extra-statutory notions for the statutory "just and reasonable" standard as the basis for evaluating the legality of rates that were placed in effect on a prospective basis and designed to permit Tennessee to recover its current costs of settling its take-or-pay liability. Respondents' attempt to defend the court of appeals' invocation of the filed rate doctrine in these circumstances is unavailing.

a. We of course agree with this Court's observations in *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 578 (1981), repeatedly quoted by respondents (Columbia, et. al., Br. in Opp. 13, 15-16, 18) [hereinafter "Br. in Opp."], that Sections 4 and 5 of the Natural Gas Act (NGA), 15 U.S.C. 717c and 717d, "bar[] a regulated seller of natural gas from collecting a rate other than the one filed with the Commission" and "prevent[] the Commission itself from imposing a rate increase for gas already sold." But neither of those things occurred here. Tennessee charged its customers only the rates that were filed with and approved by the Commission for recovering take-or-pay costs. And the Commission did not order Tennessee's customers to pay a higher rate for gas they previously purchased; instead, it approved, on a prospective basis, new filed rates that allocated current costs among Tennessee's current customers, and it did so based on the relative amounts of gas the customers did *not* purchase in a past period. Respondents, like the court below, point to nothing in Section 4 or 5 of the NGA that altogether bars the Commission, in fixing prospective rates, from taking into account the degree to which customers' past purchasing patterns contributed to the current costs those rates are designed to cover. Because Congress therefore has not spoken directly to the issue, the court below was required to defer to the Commission's reasonable interpretation of the NGA as allowing such an allocation. *Chevron U.S.A. Inc.* v. *NRDC, Inc.*,

467 U.S. 837 (1984). Yet the court did not even mention the *Chevron* principle of deference.

Respondents nevertheless seek to justify the court of appeals' invocation of the filed rate doctrine by relying (Br. in Opp. 12 n.18) on the court's conclusion that there is no difference between a charge for gas taken and a charge for gas not taken, and by asserting (Br. in Opp. 19) that the Commission orders therefore retroactively increase the rates paid by Tennessee's customers for gas they purchased in the past. However, the premise of this argument, on which respondents' entire submission rests, cannot be squared with the court of appeals' rejection elsewhere in the decision below of respondents' contention that the assessment of buyout and buydown costs against Tennessee's customers leads to prices for gas they actually purchased that exceed the ceiling price under the Natural Gas Policy Act of 1978, 15 U.S.C. 3301 *et seq.* Pet. App. 12a-17a. In rejecting this contention, the court below acknowledged that such payments "are *not* payments for gas to the extent that the gas is not taken." Pet. App. 16a (emphasis added). Other courts of appeals have reached the same conclusion. See *Diamond Shamrock Exploration Co.* v. *Hodel*, 853 F.2d 1159, 1167 (5th Cir. 1988) ("Far from being payments for the purchase of gas, take-or-pay payments are payment for the pipeline-purchaser's *failure* to purchase (take) gas."); *Kaiser-Francis Oil Co.* v. *Producer's Gas Co.*, 870 F.2d 563, 570 (10th Cir. 1989). It follows that the allocation of take-or-pay costs at issue here does not constitute a retroactive increase in the rates paid by Tennessee's customers for gas they purchased in the past.

b. Respondents argue (Br. in Opp. 17-18) that a customer "needs to know the basis on which it is currently being charged for service in order to make its own contracting and purchase decisions" and rate filings, and that the filed rate doctrine bars the Commission from determining that the filed rates "were not high enough" to recover those costs. But this is not a case in which a utility discovered after a filed rate was in effect that

it had omitted certain expenses from its rate filing and the Commission permitted the utility retroactively to alter the filed rate to recover those expenses. As respondents apparently concede (Br. in Opp. 19), the buyout and buydown costs at issue here are *current*, not past costs. The costs were not "known" and "measurable" at the time of Tennessee's earlier rate filings because they had not yet been incurred, and they therefore could not have been included in those filings. 18 C.F.R. 154.63(e)(2).

The dispositive effect that respondents (and the court of appeals) would give to the principle of predictability ignores the "sea change" the natural gas industry has undergone. Pet. App. 141a (Wald, C.J., dissenting from denial of rehearing en banc). It also is divorced from settled applications of the NGA. As respondents concede (Br. in Opp. 12), the Commission often utilizes historical data in setting just and reasonable rates. For example, under Commission regulations, 18 C.F.R. 154.63(e)(2), pipelines select past base periods for fixing new rates, and customers have no way of knowing in advance which past time frame will be selected. During the era of natural gas shortages, the Commission, with the approval of the court below, utilized the same type of base-period benchmark to allocate natural gas supplies in accordance with Sections 4 and 5 of the NGA. *City of Willcox* v. *FPC*, 567 F.2d 394, 408-412 (D.C. Cir. 1977), cert. denied, 434 U.S. 1012 (1978). In light of this precedent, the court below recognized in its recent *Transwestern* decision that pipeline customers historically have not been able to avoid payment of just and reasonable increases in fixed charges attributable to circumstances that were beyond their knowledge when they joined the system.[2]

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[2] The point is illustrated by the hypothetical example of a customer that joined an interstate pipeline system in the 1950s, reasonably expecting to pay only increased direct charges for new pipe, maintenance, etc. However, in the mid-1970s, the pipeline, at a time of gas shortages, decided to construct an expensive liquified natural gas (LNG) facility to receive and regasify LNG from overseas. The pipeline's customers would be required to pay the prudently incurred costs of building the LNG facility through an unavoidable

Expressly repudiating the contrary notion in the decision below, the court stated in *Transwestern* (897 F.2d at 579):

> In so far as prior discussions in our cases have suggested that a rate violates the filed rate doctrine simply because a customer cannot respond in some way that enables it to escape the charge * * *, such remarks were clearly inconsistent with the acknowledged power of the Commission to establish, and to alter prospectively, fixed charges such as demand charges, avoidable if at all only through the elaborate process of securing abandonment under § 7 of the Act.[3]

c. Respondents' reliance (Br. in Opp. 13, 17, 22, 26) on *Maislin Industries, U.S., Inc.* v. *Primary Steel, Inc.*, 110 S. Ct. 2759 (1990), is misplaced. The Commission's actions were fully consistent with *Maislin*'s holding that neither the seller nor the buyer may depart from the published rate known to all parties and that the Interstate Commerce Commission does not have "authority to alter the well-established statutory filed rate requirements." 110 S. Ct. at 2770. In this case, it was the court of appeals, not the Commission, that required Tennessee to depart from the filed rates for recovery of take-or-pay costs, and the court rested that holding on its own view

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direct charge, even though the facility was unanticipated when they joined the system.

[3] Respondents argue (Br. in Opp. 16 & n.23) that the surcharge is impermissibly retroactive because customers that no longer purchase gas from the pipeline may be assessed take-or-pay charges. Under the statutory regime, however, customers whose contracts have expired are still customers of the pipeline until the Commission authorizes abandonment pursuant to Section 7 of the NGA, 15 U.S.C. 717f. Whether or not it is appropriate for the Commission to permit the pipeline to assess take-or-pay liability against departing customers as a condition of abandonment does not implicate the filed rate doctrine. Rather, it requires an inquiry into whether the rate is just and reasonable and whether its assessment is consistent with Section 7 of the NGA. Moreover, this issue is hypothetical in the instant case, because no customer has left the Tennessee system.

of the filed rate doctrine, without reference to the terms of the NGA itself. That approach is at odds with *Maislin*, which makes clear that the doctrine is not a free-floating, judicially fashioned set of principles, but instead is a shorthand reference to the "*statutory* filed rate requirements," 110 S. Ct. at 2770 (emphasis added), and that a court's focus therefore must be on the statutory provisions that "make up the filed rate doctrine," *id.* at 2768. See also *id.* at 2771 (Scalia, J., concurring) (the Court's filed-rate decisions are based "on the text of the statute").

d. Respondents particularly object (Br. in Opp. 20-21) to use of the purchase-deficiency method to allocate costs incurred by Tennessee in payments to producers to reform contracts on a prospective basis, as distinguished from payments to buy out accrued take-or-pay liability. In their view, the customers' purchasing decisions between 1983 and 1986 have no relationship to Tennessee's decision to reform contract terms governing future purchases of gas. This attempt to distinguish between types of costs has nothing to do with whether the purchase-deficiency method of allocating those costs violates the statutory provisions that comprise the filed rate doctrine. As respondents concede (Br. in Opp. 21 n.31), cost causation is one of several factors to be considered in determining whether a particular rate is just and reasonable. But the court below pretermitted all inquiry on that question by concluding that the rates violate the filed rate doctrine. If this Court grants review and reverses that ruling, the case will return to the court of appeals for a determination whether the rates are just and reasonable. Only at that point would respondents' contention be germane.

Respondents' objection is insubstantial in any event. In the first place, the Commission found Tennessee's attempted breakdown of costs between buyout of liability and buydown of contractual terms on a one-third/two-thirds basis to be speculative and unsupported by the record. Pet. App. 90a. The Commission further found that "it would not be necessary to reform the con-

tracts and incur such reformation costs if Tennessee had not experienced purchase deficiencies." *Id.* at 123a. Thus, the catalyst for both the buydown and buyout of take-or-pay costs was the decrease in purchases by certain customers after Tennessee had contracted for new volumes of gas to serve the needs of its customers. Indeed, the D.C. Circuit, in *American Gas Ass'n*, recently endorsed the Commission's conclusion in Order No. 500-H that "the so-called take-or-pay problem arises in reality from 'the combination of high take and high price provisions.'" Slip op. 20. For this reason, a comprehensive resolution of the take-or-pay crisis required settlement of both existing liability and reformation of the contracts that gave rise to it, so that liability would not continue to accrue.[4] Pipelines paid only 18.6 cents on the dollar to settle their take-or-pay problems (current and future), and they passed through 39.3% of that amount to their customers under the purchase-deficiency method. Pipeline customers therefore have not been unfairly burdened with contract reformation costs.

e. Respondents' speculation (Br. in Opp. 23-26) that there are other readily available solutions to the take-or-pay pass-through problem is without merit. The notion (Br. in Opp. 24-25) that pipelines could recover these monies through their commodity charges is incorrect. The Commission afforded each pipeline the opportunity

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[4] Respondents err in relying (Process Gas Consumers Group, et al., Br. in Opp. 9-10) on the circumstances of the City of Andersonville, Georgia, which is a customer of another pipeline involved in a separate proceeding and which allegedly decreased its purchases during the deficiency period because a major purchaser of its gas switched to alternative fuels. Under Section 502(c) of the Natural Gas Policy Act of 1978, 15 U.S.C. 3412(c), the Commission may grant exemptions from its rate orders on the ground of hardship. The Commission tentatively approved such a hardship exemption for the City of Andersonville, subject to the subsequent submission of data to document the claim. *South Georgia Natural Gas Co.*, 47 F.E.R.C. ¶ 61,420 (June 21, 1989). The Commission's response to the City of Andersonville's situation thus demonstrates the basic fairness and reasonableness of the Commission's overall approach.

to recover 100% of its buyout and buydown costs in that manner but none attempted to do so, since their customers could avoid payment by decreasing or ceasing their purchases.[5] Instead, the pipelines agreed to absorb up to 50% of their costs in order to have a realistic opportunity to recover an equivalent amount through the purchase-deficiency method. The suggestion (Br. in Opp. 26) that the Commission impose either a direct charge allocated in accordance with a customer's current contract entitlement or a "volumetric" surcharge on future rates for both sales and transportation of gas is, at best, problematic. Respondents concede (Br. in Opp. 21 n.21) that an important component of the "just and reasonable" standard is that rate allocation should match as closely as possible the cost of providing service, and these methods would depart substantially from that central regulatory principle. See Pet. 28-29.

For the foregoing reasons, and those stated in the petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

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Acting Solicitor General *

WILLIAM S. SCHERMAN
General Counsel
Federal Energy Regulatory Commission

SEPTEMBER 1990

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[5] In *Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 1026 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988), the court below itself recognized that a normal commodity rate recovery was infeasible since only those pipeline customers that were "exceptionally sclerotic about purchasing gas from brokers or producers" would remain on the pipeline system and still pay these additional costs.

* The Solicitor General is disqualified in this case.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1990 262203 20108

PETITION FILED
AUG 31 1990

No. 89-2016

IN THE
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FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF AMICUS CURIAE ON BEHALF OF THE INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA IN SUPPORT OF PETITIONER

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

The Interstate Natural Gas Association of America ("INGAA") respectfully moves pursuant to Rule 37.2 for leave to file the attached brief *amicus curiae* in this case. Petitioner has consented to INGAA's filing of this brief. The consent of respondent, Columbia Gas Transmission Corporation, was requested but refused.

STATEMENT OF INTEREST

INGAA is a non-profit national trade association representing virtually all of the major interstate natural gas transmission companies operating in the United States. The companies account for over 90 percent of all natural gas transported and sold for resale in interstate commerce. INGAA's members also include major Cana-

dian interprovincial pipelines subject to regulation by the National Energy Board of Canada. INGAA's U.S. members are regulated by the Federal Energy Regulatory Commission ("Commission") under the Natural Gas Act, ("NGA"), 15 U.S.C. §§ 717 *et seq.* (1988), and to a lesser extent, under the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301 *et seq.* (1988).

REASONS FOR GRANTING THE MOTION

The United States Court of Appeals for the District of Columbia Circuit in this case held that certain orders issued by the Commission prescribing an allocation of take-or-pay costs among pipeline customers, based on a "purchase deficiency" method, violated the "filed rate doctrine." The court of appeals accordingly held that the Commission was without statutory authority to adopt such an allocation method.

All interstate pipelines that have implemented the direct billing cost recovery mechanism for take-or-pay settlement costs prescribed by Order No. 500 [1] have been required to allocate such costs using the purchase deficiency method. The Commission has reported that through late 1989 interstate pipeline companies, most of whom are INGAA members, have incurred in excess of $8 billion of such costs. Some $3.4 billion of such costs have been included in direct bill charges and allocated on a purchase deficiency basis.[2] Thus, the court of appeals' decision, if affirmed, will require a reallocation of billions of dollars of costs among natural gas consumers. Moreover, by disrupting the method by which pipelines are permitted to recover their take-or-pay costs, the decision threatens to delay substantially the transition by pipelines into the new regime of competitive gas markets.

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[1] Order No. 500, 52 Fed. Reg. 30,334 (1987), III FERC Stats. & Regs. ¶ 30,761 (1987).

[2] Order No. 500-H, 54 Fed. Reg. 52,344 (1989), III FERC Stats. & Regs. ¶ 30,867 (1989).

Apart from its unsettling impact on the allocation of take-or-pay costs, the legal conclusion reached by the court of appeals—that the filed rate doctrine prohibits the use of certain allocation methodologies—conflicts with the precedents of this Court, and constitutes an unwarranted intrusion upon the Commission's authority to prescribe ratemaking methodologies. This improper extension of the filed rate doctrine to determine questions of cost allocation will not only retard resolution of the take-or-pay problem, but it may also restrict the Commission's ability to fashion just and reasonable rates in numerous other contexts as well. INGAA urges the Supreme Court to resolve these issues and, in that regard, invites the Court to take special note of the words of Chief Judge Wald:

> I think the Court's current interpretation of the filed rate doctrine is overly rigid, at a time when the FERC needs latitude to navigate the recent dramatic changes in the structure of the natural gas industry * * *. It remains for the Supreme Court to settle this important question of how impenetrable a barrier the filed rate doctrine is to FERC's efforts at allocating the inevitable burdens stemming from fundamental readjustment of the pipeline industry.

Transwestern Pipeline Co. v. *FERC*, 897 F.2d 570 (D.C. Cir. 1990) (Wald, C.J., separate statement issued with denial of rehearing *en banc*).

INGAA, as representative of the interstate natural gas pipeline industry which is directly affected by the court of appeals' decision, has a unique perspective and interest which will aid this Court in its consideration of the issues herein.

CONCLUSION

WHEREFORE, for the foregoing reasons, INGAA respectfully requests that the following brief in support of petitioner be accepted for filing.

Respectfully submitted,

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BRIEF AMICUS CURIAE ON BEHALF OF THE INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA IN SUPPORT OF PETITIONER

INTEREST OF AMICUS CURIAE

The Interstate Natural Gas Association of America ("INGAA") is a non-profit national trade association representing virtually all of the major interstate natural gas transmission companies operating in the United States. The companies account for over 90 percent of all natural gas transported and sold for resale in interstate commerce. INGAA's members also include major Canadian interprovincial pipelines subject to regulation by the National Energy Board of Canada. INGAA's

U.S. members are regulated by the Federal Energy Regulatory Commission ("Commission") under the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717 *et seq.* (1988), and to a lesser extent, under the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301 *et seq.* (1988).

INGAA supports the petition for writ of certiorari filed by petitioner, the Commission. Four other petitions for writ of certiorari have been filed by other parties,[1] and INGAA supports such petitions to the extent that they assert that the court of appeals erred in rejecting the Commission's purchase deficiency allocation method.

SUMMARY OF ARGUMENT

During the last decade, federal regulation of the interstate natural gas pipeline industry was fundamentally altered and, as a result, the markets for natural gas as well as for services from natural gas pipelines have been irrevocably changed. Following adoption of the Natural Gas Policy Act of 1978, the Commission issued a series of orders designed to replace interstate pipelines as the principal suppliers of natural gas in favor of a system which offers additional supply alternatives to consumers. The Commission has implemented its policies through three major deregulatory initiatives which have necessitated a comprehensive restructuring of transactions for the purchase, sale, processing, and transportation of natural gas. In Order No. 380 the Commission eliminated pipeline minimum bills; in Order No. 436 the Commission provided for open-access transportation; and in

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[1] *See The Berkshire Gas Co.* v. *Associated Gas Distributors, petition for cert. pending*, No. 89-1988 (filed June 20, 1990); *Tennessee Small General Service Customer Group* v. *Associated Gas Distributors, petition for cert. pending*, No. 89-1989 (filed June 21, 1990); *Tennessee Gas Pipeline Co.* v. *Associated Gas Distributors, petition for cert. pending*, No. 89-1990 (filed June 21, 1990); and *National Fuel Gas Supply Corp.* v. *Associated Gas Distributors, petition for cert. pending*, No. 89-2000 (filed June 22, 1990).

Order No. 500 the Commission permitted recovery, in part, of past and future take-or-pay costs.[2]

The Commission's restructuring of the industry has provided pipeline customers an unprecedented array of options for obtaining gas supply service. Though inadequate, Order No. 500 has provided interstate pipelines their only reasonable opportunity to recover a portion of their take-or-pay costs which were accrued as a consequence of the sweeping market transformation effected by the Commission's orders. The D.C. Circuit's decision in *Associated Gas Distributors* v. *FERC*, 893 F.2d 349 (D.C. Cir. 1989) (*"AGD II"*), if allowed to stand, interferes with pipelines' recovery of even a portion of such costs and thereby inhibits the transition to a new market-based regulatory regime. Moreover, it throws into disarray the economic and financial assumptions that pipelines have relied upon in planning future business arrangements in the restructured marketplace and could establish an adverse precedent that will affect future Commission decisions.

The interstate pipeline industry has committed literally billions of dollars to the resolution of the take-or-pay crisis confronting it as a result of the changes wrought by the Commission in the last several years. Although the opinion of the court below involves the efforts of only one interstate pipeline, Tennessee Gas Pipeline Company ("Tennessee"), to recover its take-or-pay costs through the Commission's Order No. 500 equitable sharing mechanism, virtually all pipelines have been required to use the cost recovery mechanism prescribed by Order No. 500 in

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[2] Order No. 380, 49 Fed. Reg. 22,778 (1984), FERC Stats. & Regs. [Regulations Preambles 1982-85] ¶ 30,571 (1984), *aff'd in relevant part, Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986); Order No. 436, 50 Fed. Reg. 42,408 (1985), FERC Stats. & Regs. [Regulations Preambles 1982-85] ¶ 30,665 (1985); and Order No. 500, 52 Fed. Reg. 30,334 (1987), III FERC Stats. & Regs. ¶ 30,761 (1987).

order to recover a portion of their take-or-pay costs. And, like Tennessee, these pipelines have been required to allocate such costs among their customers using the purchase deficiency method.

As the first case to review the prescribed allocation mechanism, the court of appeals' decision is of paramount importance to the entire industry. Rather than reviewing the allocation decision under the just and reasonable standard of the Natural Gas Act, however, the court of appeals has ruled that the Commission is totally without statutory authorization to base allocations on the purchasing decisions that gave rise to the costs. While the purchase deficiency method is not the only reasonable manner of allocating take-or-pay costs, INGAA submits that the adoption of this method was well within the Commission's statutory authority.

As shown herein, the court of appeals concluded erroneously that the purchase deficiency allocation method would alter past rates; it does not. Moreover, in finding that the method violates the filed rate doctrine, the court of appeals has improperly expanded the filed rate doctrine contrary to this Court's decision in *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571 (1981) (*"Arkla"*). *See also Maislin Industries, U.S., Inc. v. Primary Steel, Inc.*, 110 S. Ct. 2759 (1990). Additionally, the court of appeals' decision usurps the Commission's role as the primary interpreter of the NGA in violation of this Court's decision in *Chevron, U.S.A., Inc.* v. *Natural Resources Defense Council*, 467 U.S. 837 (1984), thereby improperly limiting the Commission's ratemaking authority. The D.C. Circuit, in its decision herein, as well as in other recent opinions addressing the filed rate doctrine and retroactive ratemaking, has chosen to reject rate methodologies approved by the Commission, effectively substituting its judgment for that of the Commission.

INGAA submits that these legal errors, and the potential for widespread disruption of pipelines' efforts to

recover their take-or-pay costs and restructure their business arrangements in response to the new competitive market for natural gas, clearly warrant reversal of the decision. The bases for these contentions are set forth below.

ARGUMENT

I. RECENT D.C. CIRCUIT DECISIONS ARE HINDERING THE INDUSTRY'S EFFORTS TO PUT THE TAKE-OR-PAY PROBLEM BEHIND IT AND COMPLETE THE TRANSITION TO MORE COMPETITIVE GAS MARKETS.

In 1984, the Commission embarked on a program destined to bring about a radical restructuring of the natural gas industry. Until that time, interstate natural gas pipelines served as the principal aggregators and merchants of gas supplies to local distribution companies ("LDCs") and end-use markets. To carry out that function, pipelines assembled enormous inventories of gas reserves under long-term contracts. Such contracts typically obligated the pipeline to purchase a high percentage (usually 75 percent or greater) of the contractual supplies or nonetheless pay for them. Mirroring these "take-or-pay" obligations that attached to their supply contracts, interstate pipelines, with the Commission's express approval, established in their resale contracts and tariffs "minimum bills" under which LDCs and other customers were obligated to purchase a specified minimum quantity of gas. The Commission concluded in 1984 that such pipeline minimum bills, to the extent they applied to gas costs, had become "anti-competitive" in light of the enactment of the NGPA, and on that basis outlawed them.[3]

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[3] Order No. 380 permitted minimum bills to continue to operate to the extent they recovered only "fixed costs", *i.e.*, the cost of the pipelines' investment in transmission and related facilities. The Commission has since proceeded on a case-by-case basis to eliminate even fixed cost minimum bills, although in one recent instance an order abrogating such a provision was reversed because of the Commission's failure to explain why the company's take-or-pay cost

The Commission brushed aside the pipelines' objection that the elimination of minimum bills would subject them to increased take-or-pay costs without providing a means of recovery. In affirming Order No. 380, the D.C. Circuit recognized this problem but allowed the Commission to defer action on take-or-pay based on the Commission's assurance that it would address the problem in a subsequent proceeding. *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1160 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986).

The Commission continued to restructure the industry in Order No. 436. Whereas Order No. 380 allowed customers that were served by more than one pipeline to choose the lowest cost pipeline, Order No. 436 allowed customers to negotiate directly with the suppliers behind the pipelines and then to compel the pipeline to transport such gas in competition with its own long-term supplies.[4] In Order No. 436, the Commission once again failed to address substantively the take-or-pay problem, and, in

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exposure did not justify retention of the provision. *See Transcontinental Gas Pipe Line Corp.* v. *FERC*, No. 88-1741 (D.C. Cir. July 17, 1990).

[4] The Commission has argued that the "open-access" transportation program instituted by Order No. 436 was voluntary on the part of pipelines, but it was voluntary in name only. In a process that need not be detailed here, the Commission progressively eliminated any viable option to pipeline acquiescence in the open-access program. The D.C. Circuit in *Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 1024 (D.C. Cir. 1987) recognized the involuntary nature of open-access transportation:

> FERC also alludes to the "voluntary" character of pipeline provision of Order No. 436 transportation. [citation omitted]. There are two flaws in this. First, refusal of the option may spell bankruptcy: inability to provide blanket-certificate transportation for fuel-switchable users may in current market circumstances cause critical load loss. Of course acceptance of the option may also be fatal. But when a condemned man is given the choice between the noose and the firing squad, we do not ordinarily say that he has "voluntarily" chosen to be hanged.

response, the court of appeals remanded the case to the Commission to address this critical problem. *See Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988) ("*AGD I*").

In response to the remand in *AGD I*, the Commission issued Order No. 500 and set forth therein an allocation methodology based on two principles: First, that pipelines required to transport gas for third parties on an "open-access" basis could not be expected to recover their take-or-pay costs through an increase in the unit (or "commodity") cost of the gas they sold to their traditional resale customers, but would instead require some form of fixed charge that would apply irrespective of the quantity of gas sold. Second, the Commission directed that take-or-pay costs should be allocated among customers on a basis that recognizes the customer's role in take-or-pay cost "causation." In the Commission's view, this latter factor necessarily considers the customer's purchasing activities which caused take-or-pay liabilities. Although it is possible to argue that there are other reasonable cost allocation schemes, the D.C. Circuit's surprising and unsupported conclusion that the "filed rate doctrine" wholly forecloses this allocation method, regardless of its merits, actually exacerbates the problem the Commission was charged with curing. The D.C. Circuit's holding would impermissibly narrow the terrain on which the Commission's judgment and expertise may operate at the very time innovative ratemaking is most required.

The consequences for pipelines and their customers are enormous and unfortunate. The immediate effect would be to require a reallocation of approximately $3.4 billion. In most cases, this reallocation will increase the costs borne by customers that contributed least to the creation of the costs. The effect on pipelines will be even more unsettling. Interstate pipelines have attempted since 1984 to persuade the Commission to address the mounting

take-or-pay crisis that has followed on the heels of the Commission's program. It is now too late for the pipelines to avoid the costs of this crisis. What is needed instead is the prompt implementation of an effective cost recovery system. The lower court's erroneous opinion, by improperly narrowing the Commission's rate options, delays the date on which such a system can be in place, perpetuates the cloud of uncertainty that has hung over the industry through most of the 1980's, and erects a new impediment to the creation of the orderly, efficient, and competitive gas markets which the Commission has claimed it wished to foster.

II. THE COURT OF APPEALS' DECISION IMPROPERLY EXPANDS THE FILED RATE DOCTRINE AND ERRONEOUSLY CONCLUDES THAT THE PURCHASE DEFICIENCY ALLOCATION METHOD RESULTS IN RETROACTIVE RATEMAKING.

In striking down the Commission's orders in this case, the court of appeals misapplied and improperly expanded the filed rate doctrine as it has been delineated in the decisions of this Court. Contrary to the court of appeals' opinion, neither the Natural Gas Act generally, nor the filed rate doctrine in particular, imposes any restriction on the cost allocation methods available to the Commission, other than the requirement that the allocation method selected produce just and reasonable rates. Cost allocation decisions are committed to the Commission's sound discretion and judgment based on a consideration of the relevant facts. Thus, the court of appeals erred fundamentally and departed from this Court's precedent in concluding that the filed rate doctrine prohibits the purchase deficiency method.

The court of appeals apparently viewed the filed rate doctrine and the rule against retroactive ratemaking simply as different formulations of the same principle. In fact, these two concepts have different statutory sources,

have spawned separate lines of precedent and serve entirely distinct purposes. More significantly, neither concept, nor the purposes they serve, implicate any issue involving cost allocation.

The "filed rate doctrine" as it applies to natural gas companies derives from Sections 4(c) and 4(d) of the NGA, 15 U.S.C. §§ 717c(c) and (d). *Arkla*, 453 U.S. at 576-77. These statutory provisions establish the general requirements that a regulated natural gas company (a) must maintain a schedule, *i.e.*, a tariff, on file with the Commission setting forth its rates and charges, and the classifications, practices, and regulations affecting such rates and charges and (b) must not change such rates, charges, classifications, etc., without appropriate notice to the Commission. As this Court has stated, the purposes of these requirements "are preservation of the agency's primary jurisdiction over reasonableness of rates and the need to insure that regulated companies charge only those rates of which the agency has been made cognizant." *Arkla*, 453 U.S. at 577-78 (citing *City of Cleveland* v. *FPC*, 525 F.2d 845, 854 (D.C. Cir. 1976)). *See also Maislin Industries, U.S., Inc. v. Primary Steel, Inc.*, 110 S. Ct. 2759, 2766 (1990).

Thus, contrary to the decision below, the doctrine's central purpose is to protect the agency's jurisdiction, not to curtail it. It assures that the Commission, rather than the parties to a regulated transaction or courts and state agencies, retains final and exclusive authority to determine the lawfulness of the rates subject to its jurisdiction. The doctrine, accordingly, does not speak to whether a rate is too high or too low or whether it includes an improper level or category of costs. It is entirely neutral with respect to the content of the rate. When it is shown that for a given transaction a natural gas company has charged the rate that was on file with the Commission, the inquiry under the filed rate doctrine is at an end. In the instant case, there is no contention

that Tennessee has not charged the rate prescribed by its filed tariff.

The court of appeals also accepted respondents' claim that by adopting the purchase deficiency method the Commission has engaged in retroactive ratemaking. This claim too is misplaced. Indeed, the retroactive ratemaking doctrine is wholly inapposite in this case. It derives from Section 5(a) of the NGA and constitutes a limitation on the Commission's power to change rates on a prospective basis. It provides, in pertinent part:

> Whenever the Commission * * * shall find that [a] rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company * * * is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate * * * *to be thereafter observed and in force*, and shall fix the same by order.

15 U.S.C. § 717d(a) (emphasis added). The Court has described this provision as preventing "the Commission itself from imposing a rate increase for gas already sold." *Arkla*, 453 U.S. at 578. The D.C. Circuit has held that the counterpart of this provision in the Federal Power Act bars the retroactive substitution of a reasonable rate for an unreasonable one and prohibits the regulated seller from recouping past losses through a subsequent rate increase. *City of Piqua* v. *FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979) (*citing Nader* v. *FCC*, 520 F.2d 182 (D.C. Cir. 1975)). As the D.C. Circuit recently held in another case, the rule benefits or burdens buyer and seller alike, and its purpose is to assure "the finality of approved rates." *Public Utilities Commission of California* v. *FERC*, 894 F.2d 1372, 1383 (D.C. Cir. 1990).

Here, the take-or-pay costs at issue were not added to rates for sales already consummated, nor were those past rates intended to recover such costs. Indeed, Tennessee could not have filed to recover these costs in any

earlier filing. Moreover, the costs were proposed to be collected only from parties who were customers of Tennessee at the time of filing. In short, no plausible claim of retroactive ratemaking exists.

The significance of the lower court's erroneous interpretation of the filed rate doctrine transcends the facts of this case. Take-or-pay costs, to be sure, represent the largest economic consequence of the industry transition brought about by the NGPA and the Commission's regulatory initiatives, but it is far from the only consequence. Large balances of unrecovered purchased gas costs remain, stemming from retroactive producer price increases authorized by the Commission or other causes related to the transition to open-access transportation on many pipelines. Pipeline efforts to deal with these costs have been largely hamstrung by the D.C. Circuit's insistence that any form of direct billing that considers past purchases violates the filed rate doctrine. Indeed, because a mechanism to recover these costs outside the commodity charge is a prerequisite for the market-responsive pricing mechanisms contemplated by Order No. 500, the D.C. Circuit's holdings will have far-reaching implications as to the allocation of such costs and could seriously threaten the ability of pipelines to continue as gas merchants.

III. THE DECISION BELOW WOULD IMPROPERLY LIMIT THE COMMISSION'S RATEMAKING AUTHORITY.

Although purporting to decide purely an issue of statutory construction, the D.C. Circuit's decision in fact intrudes impermissibly on the ratemaking function of the Commission. As this Court has held, the Commission's authority to fix "just and reasonable rates" is exclusive, *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251 (1951), and that authority necessarily includes the right to decide any and all issues of cost allocation raised by a rate filing. In adopting an

allocation reflecting past purchases, therefore, the Commission has done no more than exercise the discretion conferred on it by the Natural Gas Act.

The lower court's holding that this allocation scheme is beyond the Commission's ratemaking powers has the inevitable effect, therefore, of dictating substantive ratemaking standards to be applied by the Commission. Although the court of appeals does not directly determine an allocation scheme, by placing extra-statutory restrictions on the Commission's ratemaking discretion it has usurped an essential administrative function. In *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844-45 (1984), this Court held:

> We have long recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer, and the principle of deference to administrative interpretations has been consistently followed by this Court whenever decision as to the meaning or reach of a statute has involved reconciling conflicting policies, and a full understanding of the force of the statutory policy in the given situation has depended upon more than ordinary knowledge respecting the matters subjected to agency regulations. [citations omitted]
>
> * * * *
>
> If [the agency's] choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned. [citations omitted]

Because the court of appeals' decision in this case neither defers to the Commission's construction of the NGA nor respects the Commission's discretion to prescribe the principles to govern the calculation of rates, it exceeds the proper bounds of the court's review func-

tion and should be reversed. Furthermore, as noted by the Commission in its petition for writ of certiorari herein (Petition at 27), the court of appeals' decision in this case is not an isolated misapplication of the filed rate doctrine. In several recent cases, the court of appeals has dictated its view of what constitutes proper ratemaking, instead of properly deferring to the Commission's judgment. *See Columbia Gas Transmission Corp.* v. *FERC*, 831 F.2d 1135 (D.C. Cir. 1987), *modified on reh'g*, 844 F.2d 879 (D.C. Cir. 1988) (*"Columbia I"*); *Columbia Gas Transmission Corp.* v. *FERC*, 895 F.2d 791 (D.C. Cir. 1990) (*"Columbia II"*), *petitions for cert. filed*, 59 U.S.L.W. 3005 (U.S. June 22, 1990) (No. 89-2001) and 59 U.S.L.W. 3065 (U.S. July 18, 1990) (No. 90-131); and *Transwestern Pipeline Co.* v. *FERC*, 897 F.2d 570 (D.C. Cir. 1990), *petition for cert. filed* (U.S. August 24, 1990) (No. 90-344). INGAA submits that this trend by the D.C. Circuit to exceed the bounds of proper appellate review by dictating its own views of ratemaking must be halted.

For the foregoing reasons, INGAA urges this Court to grant the Commission's petition for writ of certiorari and heed the call issued by Chief Judge Wald of the D.C. Circuit:

> I think the Court's current interpretation of the filed rate doctrine is overly rigid, at a time when the FERC needs latitude to navigate the recent dramatic changes in the structure of the natural gas industry * * *. It remains for the Supreme Court to settle this important question of how impenetrable a barrier the filed rate doctrine is to FERC's efforts at allocating the inevitable burdens stemming from fundamental readjustment of the pipeline industry.

Transwestern Pipeline Co. v. *FERC*, 897 F.2d 570 (D.C. Cir. 1990) (Wald, C.J., separate statement issued with denial of rehearing *en banc*).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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August 31, 1990

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